

# ANALYSIS OF ORIGINAL BILL

Author: Nazarian Analyst: Jessica Deitchman Bill Number: AB 2392  
 See Legislative  
 Related Bills: History Telephone: 845-6310 Introduced Date: February 18, 2016  
 Attorney: Bruce Langston Sponsor \_\_\_\_\_

<b>SUBJECT:</b>	Seismic Retrofit of At-Risk Property Credit
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## SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), allow a credit for costs to seismically retrofit “at-risk” buildings.

## RECOMMENDATION

No position.

## REASON FOR THE BILL

The reason for the bill is to address the state’s need to retrofit buildings for earthquake safety, by providing additional tax incentive programs to encourage taxpayers to complete seismic safety upgrades.

## EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2017, and before January 1, 2022.

## FEDERAL/STATE LAW

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current federal and state laws lack a credit comparable to the credit this bill would create.

Current law excludes from gross income grants received from the California Earthquake Authority that are granted to a residential property owner or occupant to offset the cost of earthquake loss mitigation upgrades.

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## **THIS BILL**

For taxable years beginning on or after January 1, 2017, and before January 1, 2022, this bill would allow a qualified taxpayer a credit in an amount equal to 30 percent of the qualified taxpayer's qualified costs.

The bill would define the following phrases:

- “At-risk property” means a building that is deemed hazardous and in danger of collapse in the event of a catastrophic earthquake, including, but not limited to, soft story buildings, nonductile concrete residential buildings, and pre-1994 concrete residential buildings.
- “Qualified building” means a building that has been certified as an at-risk property. A qualified building includes a mobilehome registered by the Department of Housing and Community Development.
- “Qualified costs” means the costs paid or incurred by the qualified taxpayer for any completed seismic retrofit construction on a qualified building, including any engineering or architectural design work necessary to permit or complete the seismic retrofit construction reduced by the amount of any grant provided by a public entity for the seismic retrofit construction, and does not include any of the following costs paid or incurred by the qualified taxpayer:
  - Maintenance, including abatement of deferred or inadequate maintenance, and correction of violations unrelated to the seismic retrofit construction.
  - Repair, including repair of earthquake damage.
  - Seismic retrofit construction required by local building codes as a result of addition, repair, building relocation, change of use, or occupancy.
  - Other work or improvement required by local building or planning codes as a result of the intended seismic retrofit construction.
  - Rent reductions or other associated compensation, compliance actions, or other related coordination involving the qualified taxpayer and any other party, including a tenant, insurer, or lender.
  - Replacement of existing building components, including equipment, except as needed to complete the seismic retrofit construction.
  - Bracing or securing nonpermanent building contents.
  - The offset of costs, reimbursements, or other costs transferred from the qualified taxpayer to others.
  - Any amount paid by the qualified taxpayer to the jurisdiction with authority for building code enforcement for issuing the certifications required.
- “Qualified taxpayer” means a taxpayer that is an owner of a qualified building located in this state. A taxpayer that owns a proportional share of a qualified building in this state may claim the credit based on the taxpayer's share of the qualified costs.

- “Seismic retrofit construction” means alteration of a qualified building or its components to substantially mitigate seismic damage. Seismic retrofit construction would be for work performed, and for which qualified costs were paid or incurred, on or after January 1, 2017. Seismic retrofit construction would include, but not be limited to, the following:
  - Anchoring the structure to the foundation.
  - Bracing cripple walls.
  - Bracing hot water heaters.
  - Installing automatic gas shutoff valves.
  - Repairing or reinforcing the foundation to improve the integrity of the foundation against seismic damage.
  - Anchoring fuel storage.
  - Installing earthquake-resistant bracing system for mobilehomes that are registered with the Department of Housing and Community Development.

Seismic retrofit construction would not include construction performed to bring a building into compliance with local building codes.

To be eligible for the credit, the following must apply:

1. The qualified taxpayer would be required to do all of the following:
  - Prior to the seismic retrofit construction, obtain certification from the appropriate jurisdiction with local building code enforcement authority that the building is an “at-risk property”.
  - Obtain certification from the appropriate jurisdiction with authority for building code enforcement, upon a review of the building, that the completed construction satisfies the definition of seismic retrofit construction. The certification would identify what part of the completed construction, if any, is not seismic retrofit construction and specify a dollar amount of qualified costs.
  - Request and be granted an allocation of the credit from the Franchise Tax Board (FTB). To request an allocation, the taxpayer must sign and submit to the FTB an application to receive credit for the seismic retrofit construction and provide a copy of the certification.
  - Retain for his or her records a copy of the certifications.
2. The jurisdiction with authority for building code enforcement in which a qualified building is located has entered into an agreement with the state to provide certifications and to not seek reimbursement pursuant to Section 6 of Article XIII B of the California Constitution for any costs incurred in providing those certifications.

The qualified taxpayer would be required to claim one-fifth of the credit amount for the taxable year in which the credit is allocated and one-fifth of the credit amount for each of the subsequent four taxable years.

This bill would allow unused credits to be carried over for up to five years, if necessary.

The total amount of credit that may be allocated could not exceed the sum of the following:

- \$12,000,000 for the 2017 calendar year and each calendar year thereafter.
- The amount of previously unallocated credits allowed.

Upon receipt of the application and certification, the FTB would notify the taxpayer of the amount of credit allowed, if any, and allocate the credit to the taxpayer on a first-come-first-served basis.

The taxpayer must claim the credit on a timely filed original return.

The determination of the FTB with respect to the allocation of the credit, and whether a return has been timely filed may not be reviewed in any administrative or judicial proceeding.

Any disallowance of a credit claimed due to a determination, including the application of the limitation of \$12,000,000 per calendar year, would be treated as a mathematical error appearing on the return. Any amount of tax resulting from that disallowance may be assessed by the FTB in the same manner as provided by Section 19051.<sup>1</sup>

This credit would be in lieu of any other credit or deduction that the qualified taxpayer may otherwise claim under the PITL and CTL with respect to qualified costs.

The FTB may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this bill, including any guidelines regarding the allocation of the credit allowed. The rules, guidelines or procedures would be exempt from the Administrative Procedure Act.

This credit would remain in effect only until December 1, 2022, and as of that date is repealed.

To assist with their review of the effectiveness of the tax credit, the Legislative Analyst may request information from the FTB and any state governmental entity with authority relating to the seismic retrofit construction of at-risk properties. The FTB would be required to provide to the Legislative Analyst any data requested.

## **IMPLEMENTATION CONSIDERATIONS**

Implementing this bill would require changes to existing tax forms and instructions and information systems.

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<sup>1</sup> Any amount of tax, due to a mathematical error, of which a notice has been mailed, is not a deficiency assessment. The taxpayer has no right of protest or appeal based on that notice.

## **TECHNICAL CONSIDERATIONS**

To provide clarity for the department and taxpayers, it is recommended the bill be amended to specify an ordering rule for claiming the carryover credits in regards to the one-fifth usage requirement. For example, if a taxpayer can use one-fifth of the credit in year one, but carries over half of the credit from year one to year two, would the taxpayer have to use the remaining credit carried over from year one in year two? Or would the taxpayer use the one-fifth of the credit allowed in year two first.

## **LEGISLATIVE HISTORY**

AB 428 (Narzarian, 2015/2016), would have, similar to this bill, allowed a credit for seismic retrofits of at risk property. AB 428 was vetoed by Governor Brown on October 10, 2015, because “despite strong revenue performance over the past few years, the states’ budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, the next year’s budget faces the prospect of over \$1 billion in cuts. Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state’s budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations.”

SB 84 (Committee on the Budget, Chapter 25, Statutes of 2015) among other things, added language allowing an exclusion from gross income for amounts received as a loan, loan forgiveness, grant, credit, rebate, voucher, or other financial incentive issued by the California Residential Mitigation Program or the California Earthquake Authority to assist a residential property owner or occupant with expenses paid or obligations incurred for earthquake loss mitigation.

AB 1510 (Nazarian, 2013/2014) would have, similar to this bill, allowed a credit for seismic retrofits of a risk property. AB 1510 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

## **OTHER STATES’ INFORMATION**

*Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws lack a credit comparable to the credit allowed by this bill. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

## **FISCAL IMPACT**

This bill would impact the department’s printing, processing and programming costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

## ECONOMIC IMPACT

### Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2392 As Introduced February, 18, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$0.8	- \$2.7	- \$4.7

This estimate assumes that there will be no new mandates requiring retrofitting activities anywhere in the state. The costs could increase significantly if a state-wide mandate is put in place.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

### Revenue Discussion:

This bill would establish a credit for qualified costs incurred for seismic retrofit construction on an at-risk building. The maximum credit allocation would be capped at \$12 million per calendar year. Based on discussions with industry experts and 2014 U.S. Census data on buildings in earthquake areas, it is estimated that approximately 2,090 buildings would undergo retrofitting each year. The California Seismic Safety Commission indicates the retrofitting cost is approximately \$20,000 for residential housing, \$10,000 for mobile homes, and \$100,000 for commercial buildings. This data results in an estimated \$83 million dollars in retrofitting costs for 2014. The estimate was grown for inflation to \$88 million in qualified expenditures for 2017, then reduced by the estimated amount of retrofitting grants issued annually of \$10 million; resulting in approximately \$78 million in qualified retrofitting costs for 2017. The credit would be equal to 30 percent of a qualified taxpayer's qualified costs. This results in approximately \$23 million in credit generated in 2017.

Because the estimated annual retrofitting activity is expected to exceed the cap of \$12 million, the total qualifying credit for 2017, and each year thereafter, would be \$12 million. The credit must be claimed evenly over 5 years, resulting in \$2.4 million available in tax year 2017. The credit available would peak when there is a five combined year period in 2021 at \$12 million. Experience shows that 70 percent of the available credit would be used in the year the credit is generated and the remaining 30 percent of the credit would be used over the subsequent four years. This results in credit usage of approximately \$1.7 million in taxable year 2017 and peaking in 2021 at approximately \$10.6 million. An adjustment was made to reflect the decreased depreciation deduction allowed when the credit is claimed.

The tax year estimates were converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

## **SUPPORT/OPPOSITION**

Support: None provided.

Opposition: None provided.

## **ARGUMENTS**

Proponents: Some may argue that the bill would encourage taxpayers to make necessary upgrades to existing buildings to make them earthquake safe, thus improving safety for all Californians.

Opponents: Some may argue that providing a tax credit limited to retrofitting at-risk buildings may be overly narrow and inadvertently exclude other safety issues in California that need attention.

## **LEGISLATIVE STAFF CONTACT**

Jessica Deitchman  
Legislative Analyst, FTB  
(916) 845-6310

[jessica.deitchman@ftb.ca.gov](mailto:jessica.deitchman@ftb.ca.gov)

Jame Eiserman  
Revenue Manager, FTB  
(916) 845-7484

[jame.eiserman@ftb.ca.gov](mailto:jame.eiserman@ftb.ca.gov)

Gail Hall  
Legislative Director, FTB  
(916) 845-6333

[gail.hall@ftb.ca.gov](mailto:gail.hall@ftb.ca.gov)