ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Cohn	Analyst:	Gloria McConnell	Bill Number:	AB 278
Related Bills:	See Legislative History	Telephone:	845-4336	Amended Date	03/22/2001
		Attorney:	Patrick Kusiak	Sponsor:	Governor Davis

SUBJECT: Manufacturers' Investment Credit/Increase to 7% & Extends Repeal Date

SUMMARY

This bill would increase the Manufacturer's Investment Credit (MIC) from 6% to 7% of the cost of certain property used in manufacturing activities and extend the credit until at least January 1, 2008.

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to increase the incentive for manufacturing businesses to remain or locate in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business and allow a depreciation deduction for the obsolescence or wear and tear of property used in a business or for investment property.

Existing federal law does not have a credit comparable to the MIC.

Existing state law allows qualified taxpayers a credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

Board Position:			Department Director	Date
______ S	______ NA	______ NP	Alan Hunter for GHG	03/30/01
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For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code and used primarily:

- for manufacturing, processing, refining, fabricating, or recycling of property;
- for research and development;
- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control that meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) For certain taxpayers engaged in specified SIC Code activities, special purpose buildings and foundations.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software, and the value of any capitalized labor costs directly allocable to such property.

The MIC explicitly excludes certain types of property from the definition of qualified property, such as furniture, inventory, and equipment used in an extraction process.

The MIC would sunset on January 1, 2001, or January 1st of the earliest subsequent year if the Employment Development Department determines that manufacturing (excluding aerospace) employment in California on the preceding January 1st does not exceed the January 1, 1994, employment level by at least 100,000 jobs. This employment test (100,000 additional manufacturing jobs) has already been met, thus the MIC will not expire unless California suffers from a severe recession and loses a significant number of manufacturing jobs.

THIS BILL

This bill would increase the MIC from 6% to 7% of the qualified cost of qualified property placed in service in taxable years beginning on or after January 1, 2001. The 1% increase would not apply to MIC carryovers.

This bill would extend the repeal date from January 1, 2001, to January 1, 2008. Thus, the MIC would be repealed on January 1, 2008, or January 1st of the earliest subsequent year that the manufacturing employment evaluation test is not met.

This bill also would make minor technical changes to delete obsolete language referencing the low-emission vehicle credit and change “which” to “that” in various places.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

AB 1062 (Battin; 1997/1998) would have increased the MIC from 6% to 8% of qualified costs. AB 1062 was held in the Assembly Revenue and Taxation Committee.

AB 473 (Hertzberg; 1999/2000) would have extended the repeal date to January 1, 2004. AB 473 was held in the Senate Appropriations Committee. *AB 2461, Runner (1999/2000)* would have increased the MIC from 6% to 8% of qualified costs. AB 2461 was held in the Assembly Revenue and Taxation Committee.

AB 110 (Zettel; 2001/2002) would increase the MIC from 6% to 9% of qualified costs. AB 110 is in the Assembly Revenue and Taxation Committee. *AB 240 (Runner; 2001/2002)* would increase the MIC to 7%, extend the credit to taxpayers engaged in mineral extraction or electric power generation activities, and delete the repeal date. *AB 290 (Cogdill; 2001/2002)* would extend the MIC to taxpayers engaged in certain agricultural or nonmetallic mineral extraction activities. *AB 45X (Kelley; 2001/2002)* would extend the MIC to taxpayers engaged in certain electric power generation activities. AB 45X is with the Assembly Revenue and Taxation Committee. *SB 559 (Morrow; 2001/2002)* would increase the MIC from 6% to 8% of qualified costs. SB 559 is with Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The laws of the following states were reviewed because their tax laws are similar to California's income tax laws:

NewYork provides an investment tax credit (ITC) to manufacturers for certain depreciable equipment or buildings. The credit is 5% of up to $350 million of qualified expenditures and 4% for qualified expenditures in excess of $350 million. Certified pollution control, industrial waste treatment, and acid rain control facilities also qualify for this credit. Research and development (R&D) property may qualify for an optional rate of 9%.

Illinois provides a replacement tax investment credit equal to 0.5% of the basis of qualified property used by a taxpayer primarily engaged in manufacturing, retailing, coal mining, or fluorite mining.

Massachusetts provides a 3% credit based on the cost of qualified property used for manufacturing, farming, fishing, or research and development.

Michigan provides a graduated investment tax credit based on adjusted gross receipts of a firm. The credit is a percentage (0.85% to 2.3%) of the net costs of qualifying tangible, depreciable assets located in Michigan.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue loss from this bill is as follows:

Revenue Impact of AB278 For Taxable Years Beginning on or After January 1, 2001 Enactment Assumed After June 30, 2001 (In Millions)		
2001-2	2002-3	2003-4
-$65	-$75	-$80

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

Increase MIC from 6% to 7%

The revenue impact of this provision would depend on the increased credit amounts and the tax liability of qualified taxpayers.

These estimates are based on microsimulation models of California tax returns for tax years 1997 and 1998 and grown to approximate 2001 and beyond. The credit use rates taken from the models were then applied to derive the aggregate credit use. The fiscal year cash flow patterns are based on the department's analysis of how manufacturers adjusted their tax payments to reflect the reduction in liability resulting from the current law MIC.

Extend the Repeal Date for MIC

Extending the repeal date from the MIC would not impact current revenues. It is anticipated that the MIC would not sunset under the current law requirement.

ARGUMENTS/POLICY CONCERN

This bill would increase the incentive for qualified property that is purchased pursuant to a binding contract entered into before January 1, 2001, but placed in service in a taxable year beginning on or after that date. Any qualified costs paid pursuant to that contract would qualify for the increased credit rate provided under this bill even though the taxpayer's business decision to proceed with their project has already occurred.

LEGISLATIVE STAFF CONTACT

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