Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Dutra & Nakano	Analyst:	Norman Catelli	Bill Number:	AB 1674
Related Bills:	See Legislative History	Telephone:	845-5117	Amended Date:	April 7, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Manufacturers' Investment Credit/Delete Repeal Date to Extend Indefinitely

SUMMARY

This bill would extend the Manufacturers' Investment Credit (MIC) indefinitely by removing the existing repeal provision, which is currently contingent on increasing the level of manufacturing employment.

This analysis addresses only those provisions of the bill affecting the Franchise Tax Board (FTB).

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

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

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2003.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

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 the production of income.

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	Gerald H. Goldberg	05/05/03
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The MIC sunsets on January 1st of 2001, or the earliest subsequent year thereafter 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. Based on the Governor's Budget (2003-2004) economic forecast, decreases in manufacturing employment are expected to cause the MIC to sunset on January 1, 2004.

THIS BILL

This bill eliminates the repeal provision of the MIC. Thus, this bill would extend the MIC credit indefinitely.

IMPLEMENTATION CONSIDERATIONS

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

TECHNICAL CONSIDERATIONS

This bill would delete subdivision (i) and redesignate subdivisions (j) and (k) of Sections 17053.49 and 23649 of the Revenue and Taxation Code. Subdivisions (j) and (k) provide operative dates for changes made to the MIC since its original enactment. Since these subdivisions contain the phrase "the amendments made by the act adding this subdivision shall be operative" and this bill would redesignate the subdivisions, taxpayers may have difficulty determining when the previous change became operative. The attached Amendments 1 through 4 would resolve this issue by citing the specific laws that changed the MIC.

LEGISLATIVE HISTORY

SB 2X (Poochigian, 2003-2004) and SB 47 (Ackerman, 2003-2004) are identical to this bill. SB 2X and SB 47 are scheduled for hearing in the Senate Revenue and Taxation Committee on April 30, 2003.

SB 137 (Morrow, 2003-2004) would increase the MIC rate from 6% to 8% and extend the credit indefinitely. SB 137 is scheduled for hearing in the Senate Revenue and Taxation Committee on April 30, 2003.

SB 454, (Vasconcellos, 2003-2004) would extend the MIC until January 1, 2009. SB 454 is scheduled for hearing in the Senate Revenue and Taxation Committee on April 30, 2003.

AB 122 (Calderon, 2003-2004) would extend the repeal date of the MIC until at least January 1, 2009. AB 122 is being held in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The following states were surveyed due to their similarities to California's economy, business entity types, and tax laws.

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.

New York 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%.

FISCAL IMPACT

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

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The following revenue impact assumes that the MIC would become inoperative under current law starting with investments put in place on or after January 1, 2004.

The bill would result in the following revenue losses:

Estimated Revenue Impact For Investments Put In Place After January 1, 2004 Assumed Enactment After June 30, 2003 (In Millions)		
2003-04	2004-05	2005-06
-$40	-$195	-$345

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

<u>Revenue Discussion</u>

Based on the Governor's Budget (2003-2004) economic forecast, decreases in manufacturing employment are expected to cause the MIC to sunset on January 1, 2004. This bill would delete the repeal date and extend the MIC indefinitely. The revenue effect of the MIC credit is generally determined by the following formula:

"Qualified costs" incurred in "qualifying activities" by a "qualified taxpayer" multiplied by 6% equals the gross amount of the MIC credit earned.

The amount of MIC credit allowed to reduce tax liability is limited by the amount of alternative minimum tax, if any, for the year. Other tax rules require a carryover credit to be applied to the limitation amount until exhausted. The newly-earned credit may be applied to any remaining tax liability balance. The amount of the newly-earned credit actually applied to tax liability is the revenue impact. Any credit not applied to the current year tax liability is a carryover to the next year.

The fiscal year cash flow patterns are based on the department's analysis of how taxpayers adjust their tax payments to reflect the reduction in liability resulting from the current law MIC credit amount.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1674
As Amended April 7, 2003

AMENDMENT 1

On page 19, modify line 31 as follows:

The amendments made by ~~the act adding this subdivision~~ Chapter 954 of the Statutes of 1996

AMENDMENT 2

On page 19, modify line 35 as follows:

(j) The amendments made by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998

AMENDMENT 3

On page 31, modify line 12 as follows:

The amendments made by ~~the act adding this subdivision~~ Chapter 954 of the Statutes of 1996

AMENDMENT 4

On page 31, modify line 16 as follows:

(j) The amendments made by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998