

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Morrow Analyst: Norman Catelli Bill Number: SB 137

Related Bills: See Legislative History Telephone: 845-5117 Introduced Date: February 6, 2003

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Manufacturers' Investment Credit/Increase Percentage to 8% and Delete Repeal Date to Extend Indefinitely

SUMMARY

This bill would:

- increase the Manufacturers' Investment Credit (MIC) rate from 6% to 8% of the cost of property used in manufacturing, and
- extend the credit indefinitely.

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

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 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:

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Department Director
Gerald H. Goldberg

Date
03/04/03

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 increases the MIC rate from 6% to 8% of the cost of qualified property used by a qualified taxpayer in a qualified activity. This bill also eliminates the existing repeal provision of the MIC. Thus, the bill would make the MIC permanent. The bill also makes some technical, nonsubstantive changes to the MIC.

IMPLEMENTATION CONSIDERATIONS

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

TECHNICAL CONSIDERATIONS

Amendments 1 through 4 would reference the specific previously enacted laws that changed the MIC.

LEGISLATIVE HISTORY

SB 2X (Poochigian, 2003-2004) and SB 47 (Ackerman, 2003-2004) would remove the repeal date from the MIC, effectively extending the credit indefinitely. SB 2X and SB 47 are in the Senate Revenue and Taxation Committee awaiting hearing dates.

AB 122 (Calderon, 2003-2004) would extend the credit until at least January 1, 2006. AB 122 is in the Assembly Revenue and Taxation Committee awaiting a hearing date.

SB 559 (Morrow, 2001-2002) would have increased the MIC rate from 6% to 8% of qualified costs. SB 559 failed passage in the Senate 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 2145 (Knight, 1999-2000) would have removed the repeal date from the MIC, extending the credit indefinitely. SB 2145 was held in the Senate Revenue & 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:

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%.

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

The following revenue impact assumes that the MIC would become inoperative under current law starting with investments put in place 1/1/2004.

Estimated Revenue Impact Operative for Taxable Years Beginning on or After January 1, 2003 Assumed Enactment After June 30, 2003 (In Millions)		
2003-04	2004-05	2005-06
-\$85	-\$250	-\$420

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

Revenue Discussion

It is anticipated based on economic forecasts that decreases in manufacturing employment are expected to cause the MIC to sunset on January 1, 2004. This bill would increase the MIC rate from 6% to 8% for taxable years beginning on or after January 1, 2003, and would delete the repeal date, making the MIC permanent. This estimate is based on a micro simulation model of California tax returns for taxable year 2000. These numbers were grown to approximate 2001 and beyond. The above estimate represents newly generated credits pursuant to this bill applied to tax liabilities after application of credit carryovers from previous taxable years. Therefore, any revenue loss would be as a result of newly generated credits. 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.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 137
As Introduced February 6, 2003

AMENDMENT 1

On page 19, modify line 17 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 21 as follows:

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

AMENDMENT 3

On page 30, modify line 35 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 1 as follows:

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