ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Runner	Analyst:	Norman Catelli	Bill Number:	AB 1665
Related Bills:	See Legislative History	Telephone:	845-5117	Introduced Date:	February 21, 2003
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Manufacturers' Investment Credit/Delete Condition for Classification of Costs as Qualified Costs

SUMMARY

This bill would remove the requirement that sales or use tax be paid on otherwise qualified property eligible for the Manufacturers' Investment Credit (MIC).

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, the income tax provisions of 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 trade or business and allow a depreciation deduction for the obsolescence or wear and tear of property used in a trade or 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
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LSB TEMPLATE (rev. 6-98)

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 (IRC), used in a qualified SIC Code activity, and used primarily for:

- manufacturing, processing, refining, fabricating, or recycling of property;
- research and development;
- the maintenance, repair, measurement, or testing of otherwise qualified property; or
- 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 sunsets on January 1st of 2001 or 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. 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

The bill eliminates the requirement that sales or use tax be paid on the cost of qualified property (except certain capitalized labor not subject to sales tax) eligible for the MIC credit. Thus, certain taxpayers may be eligible for a sales tax exemption and a credit on the same item of otherwise qualified property.

The bill also makes minor non-substantive changes to the existing statute.

IMPLEMENTATION CONSIDERATIONS

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

TECHNICAL CONSIDERATIONS

The Governor's Budget anticipates decreases in manufacturing employment to cause the MIC to sunset on January 1, 2004. The author might consider an amendment to extend the sunset date. Subdivision (f) of Sections 17053.49 and 23649 (in paragraphs (3), (4), and (5)) contains numerous references to the paragraph deleted by this bill. These references should be deleted.

Department staff is available to assist the author with these amendments.

The attached Amendments 1 through 4 would reference the specific laws that previously 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 being held in the Senate Revenue and Taxation Committee.

SB 137 (Morrow, 2003-2004) would remove the repeal date from the MIC, effectively extending the credit indefinitely. SB 137 also would raise the MIC rate from 6% to 8%. SB 137 is being held in the Senate Revenue and Taxation Committee.

SB 454 (Vasconcellos, 2003-2004) would extend the credit until January 1, 2009, and establish certain reporting requirements. SB 454 is being held in the Senate Revenue and Taxation Committee.

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

AB 1674 (Dutra, 2003-2004) would remove the repeal date from the MIC, effectively extending the credit indefinitely. AB 1674 is scheduled to be heard in the Assembly Revenue and Taxation Committee on May 5, 2003.

OTHER STATES' INFORMATION

The laws of the following states were reviewed due to their similarities to California's economy, business entity types, and 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

Although this bill's sales tax provision would have an impact on total state tax revenue, the impact on state income tax revenue would be negligible.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1674
As Introduced February 21, 2003

AMENDMENT 1

On page 20, modify line 36 as follows:

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

AMENDMENT 2

On page 21, modify line 1 as follows:

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

AMENDMENT 3

On page 32, modify line 19 as follows:

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

AMENDMENT 4

On page 32, modify line 22 as follows:

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