# ANALYSIS OF ORIGINAL BILL

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| Author: | Ackerman | Analyst: | Norman Catelli | Bill Number: | SB 47 |
| Related Bills: | See Legislative History | Telephone: | 845-5117 | Introduced Date: | January 9, 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 contingent on increasing the level of manufacturing employment..

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: | | | Department Director | Date |
|---|---|---|---|---|
| ______ S | ______ NA | ______ NP | Gerald H. Goldberg | 01/29/03 |
| ______ SA | ______ O | ______ NAR | | |
| ______ N | ______ OUA | __X__ PENDING | | |

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. It is anticipated, based on current economic forecasts, that 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 renumber 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) is identical to this bill. SB 2X is in the Senate Revenue and Taxation Committee awaiting a hearing date.

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**

<u>Revenue Estimate</u>

The following revenue impact assumes that the MIC would become inoperative under current law on January 1, 2004. Therefore, this bill is evaluated as a new tax expenditure rather than as a continuation of the MIC.

| Estimated Revenue Impact<br>For Investments Put In Place<br>On or After January 1, 2004<br>Assumed Enactment After June 30, 2003<br>(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>

It is anticipated, based on current economic forecasts, that 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. 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 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.

**LEGISLATIVE STAFF CONTACT**

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 47
As Introduced January 9, 2003

AMENDMENT 1

On page 19, modify line 24 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 28 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 1 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 5 as follows:

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