Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Dymally	Analyst:	Raul Guzman	Bill Number:	AB 1887
Related Bills:	See Prior Analysis	Telephone:	845-4624	Amended Date:	May 9, 2006
		Attorney:	Patrick Kusiak	Sponsor	

SUBJECT: Digital Arts Studio Partnership Demonstration Program Credit

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ____________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as amended April 20, 2006 ____________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ____________ STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This bill would allow a credit to corporate taxpayers for support of digital media arts.

SUMMARY OF AMENDMENTS

The May 9, 2006, amendments deleted the $5 million annual allocation language and replaced it with new allocation language. The bill as amended also added language that specifies how the commission can allocate the credit to taxpayers.

As a result of the May 9, 2006, amendments, the new credit allocation information will be added to the “This Bill” portion of the analysis. The department’s remaining “Technical Consideration” regarding AB 252 has not been addressed and is repeated below for convenience. New “Economic Impact” information is being provided. The remainder of the analysis of the bill as amended March 23, 2006, still applies.

THIS BILL

The amendments would provide a new annual allocation for the first five years. The annual allocations would be as follows:

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	05/17/06
____ N	____ OUA	__X__ PENDING		

Calendar year	Annual Allocation Amount
2007	$1,000,000
2008	$2,000,000
2009	$3,000,000
2010	$4,000,000
2011	$5,000,000 and, each calendar year thereafter.

This amendment would specify that the commission's allocated credit to a taxpayer may not exceed 20% of the taxpayer's expenses incurred for the support of the program.

TECHNICAL CONSIDERATIONS

This bill states that it would only be operative if AB 252 becomes operative. AB 252, as currently drafted, would not establish the Digital Arts Studio Partnership Demonstration Program. AB 252 proposes to amend Section 8778 of the Government Code; this section was repealed on January 1, 2006. Consequently, AB 252 as currently drafted is legally defective.

ECONOMIC IMPACT

Revenue Estimate:

Based on data and assumptions discussed below, the PIT and Corporation Tax revenue gain/loss from this bill would be as follows:

Estimated Revenue Impact of AB 1887 Effective On Or After January 1, 2006 Enactment Assumed After June 30, 2006 ($ in Millions)					
Digital	2006-07	2007-08	2008-09	2009-10	2010-11
Media	-$0.55	-$1	-$2	-$2.5	-$3

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

Revenue Discussion:

This bill enacts corporate tax credits for the support of a digital media arts studio partnership demonstration program. The allocation amount is increased each year by $1 million until the cap is $5 million in 2011, and each year thereafter. This estimate assumes the technical perfection, and passage, of companion legislation AB 252. The estimate assumes that only 80 percent, or $800,000, of the credit will be allocated in 2007. The remainder of the first year credit will be carried over and allocated in the second year. It is also assumed that taxpayers will only be able to use 80 percent of the credit that is granted. Therefore the credit usage for 2007 would be $640,000 ($800,000 X 80%).

There will also be a partial offset to this revenue loss because taxpayers who claim the credit will lose the ability to claim the corresponding deduction that they would be claiming in the absence of this credit. The estimate assumes that 30 percent of the qualifying expenditures will be for depreciable property. For depreciable property, it is assumed that the credit would be taken in lieu of 3 year straight-line depreciation. For the expenses other than those related to depreciable property, the loss of deductions would be equal to the amount of credit claimed. The tax offset would be equal to the sum of lost depreciation deductions and the loss of other deductions times the appropriate marginal tax rate. The total amount of the deduction offset was estimated to be $500,000 [($640,000 X 30 % X 1/3) + ($640,000 X 70%)].

The appropriate marginal tax rate depends on the marginal tax rates for the affected taxpayers. It was assumed that 20 percent of credit would be claimed by subchapter S corporations and have an effective tax rate of 1.5 percent. The remainder would have a marginal tax rate of 8.84 percent. The average marginal tax rate would, therefore, be 7.37% [(1.5 % x 0.2) + (8.84% x 0.8)]. The total amount of the offset for 2007 would be, therefore, $50,000 (7.37% X $600,000).

The net impact of the bill for 2007 would be $550,000, or the net of the $600,000 credit and the $50,000 offset. This estimate assumes the S-corporations are allowed to take 1/3 of the credits. It also assumes that, as the bill is currently drafted, none of the credit claimed by S-corporations can be passed through to the owners. The results presented in the table above are adjusted to reflect fiscal year estimates.

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