

SUMMARY ANALYSIS OF AMENDED BILL

Author: Lieu Analyst: Rachel Coco Bill Number: AB 2032
 Related Bills: See Prior Analysis Telephone: 845-4328 Amended Date: April 17, 2006
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Research Expenses Credit/Conformity

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

X _____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _____.

X _____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 14, 2006 STILL APPLIES.

_____ OTHER – See comments below.

SUMMARY

This bill would increase the amount of the qualified Research Expense credit.

SUMMARY OF AMENDMENTS

The April 17, 2006, amendments would conform to the federal Research Expense credit by increasing the amount of the qualified research expense credit from 15% to 20%. The amendments also would increase the alternative incremental portion of the credit to result in greater conformity to the federal amount.

As a result of these amendments, the “This Bill” discussion as provided in the analysis of the bill as introduced February 14, 2006, has been revised and a Technical Concern has been identified. Also, the amendments impact revenue and a new estimate is provided below. The remainder of the department’s analysis of the bill as introduced February 14, 2006, still applies.

POSITION

Pending.

Board Position:	Legislative Director	Date
_____ S	Brian Putler	4/21/06
_____ NA		
_____ SA		
_____ N		
_____ OUA		
_____ NP		
_____ O		
_____ NAR		
_____ X PENDING		

THIS BILL

For taxable years beginning on and after January 1, 2007, this bill would increase the amount of the qualified Research Expense credit from 15% to 20%.

This bill would fully conform to federal law pertaining to the alternative incremental research portion of the credit by referencing the percentages allowed at the federal level, resulting in an increased percentage for state purposes.

By increasing the amount of the Research Expense credit and the percentage of the alternative incremental research portion of the credit, this bill would fully conform to the federal provisions, other than a continuing difference for basic research payments. The federal credit for basic research is provided to all taxpayers at a percentage of 20%. The California credit is limited to taxpayers subject to the Corporation Tax Law at a percentage of 24%.

TECHNICAL CONSIDERATIONS

It appears the author's intent is to conform to the federal provisions relating to the alternative incremental research credit. Some of the language that was added to make that change is unnecessary and conflicts with existing provisions of law. Specifically, the language that would explicitly conform to IRC Section 41(c)(4) for taxable years beginning on or after January 1, 2007, should be removed. That language is unnecessary because other language added by the amendment states that the modification to IRC Section 41(c)(4) is limited to taxable years beginning before January 1, 2007. In addition, the language conflicts with provisions of existing law immediately following that modify other aspects of IRC Section 41(c)(4).

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 2032 As amended April 17, 2006 Effective for tax years Beginning On or After 1/1/2007 Enacted by 6/1/2006 \$ Millions				
	2006-07	2007-08	2008-09	2009-10
Higher qualified Research Expense credit rate	-\$19	-\$81	-\$81	-\$86
Higher AIRC credit rates	-\$1	-\$4	-\$4	-\$4
Total	-\$20	-\$85	-\$85	-\$90

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

Revenue Discussion

The above revenue impact was estimated as follows. First, the revenue loss due to higher qualified Research Expense credit rates was estimated for 2003 using a sample of corporate tax return. For each corporation in the sample, the tax liabilities under the current and proposed laws were simulated taking into account its taxable income, net operating losses, qualified research expenses, and the Research Expense credit rates. Not all the additional research credits generated in a particular year would be used in that year. Taxpayers without sufficient tax liability would not be able to fully use the additional credits. Unused credits would be carried forward to subsequent years. Simulation results show that of the \$535 million additional qualified research credits created in 2003, only \$60 million would be used in reducing tax liability for the same tax year. The alternative incremental research credit (AIRC) currently accounts for about 2% of the qualified Research Expense credit claimed. The percentage increases in the AIRC credit rates under this bill are much higher than that of the qualified Research Expense credit rate. Therefore, we assume that the revenue loss due to higher AIRC rates would be about 5% of the loss from the higher qualified Research Expense credit rate.

The results from the simulation were expanded from the sample to the corporate population and extrapolated to later years. The extrapolation was based upon the latest DOF forecast for corporate profits.

Finally, the PIT revenue impact was calculated using the ratio of PIT Research Expense credits to corporate Research Expense. Because this ratio in 2003 was 6%, it was assumed that under this bill the PIT revenue impact would also be 6% of the corporate impact.

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