

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Lieu Analyst: Rachel Coco Bill Number: AB 2033

Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: February 14, 2006

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Joint Strike Fighter/Extend Repeal Date to December 1, 2011

SUMMARY

This bill would extend the Joint Strike Fighter (JSF) wage and property credits for five additional taxable years.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to encourage taxpayers to continue to manufacture aerospace equipment within the state.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2006, and before January 1, 2011.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current state law allows qualified taxpayers a wage credit and a property credit under the JSF program. Qualified taxpayers are those under an initial contract or subcontract to manufacture property for ultimate use in a JSF.

The *wage credit* is equal to a specified percentage of employee wages, not to exceed \$10,000 per year, per qualified employee, that are direct costs allocable to property manufactured in this state for ultimate use in a JSF, with certain limitations.

The *property credit* is equal to 10% of the cost of qualified property used by a taxpayer primarily in qualified activities to manufacture a product for ultimate use in a JSF, with certain exceptions.

The credits are available for taxable years beginning on or after January 1, 2001, and before January 1, 2006, and are repealed as of December 1, 2006. Any excess credit can be carried forward for up to eight years.

There are no comparable federal credits specifically for the JSF program.

Board Position:

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Department Director

Date

Selvi Stanislaus

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THIS BILL

This bill would extend the time for which the JSF wage and property credits are available to taxable years beginning on or after January 1, 2006, and before January 1, 2011. The bill also revises the repeal date for the credit to December 1, 2011.

IMPLEMENTATION CONSIDERATIONS

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

LEGISLATIVE HISTORY

AB 485 (Runner, 2001/2002) would have extended the JSF credits for two years, from 2006 to 2008. This bill failed to pass out of the house of origin before the constitutional deadline.

AB 2797 (Machado, Stats. 1998, Ch. 322) enacted the JSF credits.

PROGRAM BACKGROUND

The JSF Program is the Department of Defense's focal point for defining affordable next generation strike aircraft weapon systems for the Navy, Air Force, Marines, United Kingdom Royal Navy, and other U.S. allies.

The current phase of the program is known as the System Development & Demonstration phase and is expected to take 10 years. Lockheed Martin, using pieces manufactured by several other companies in various states, including California, will assemble a total of 22 test aircraft to be used in flight testing, non-airborne testing, and evaluation of the radar signature. The assembly will take place at Lockheed Martin's Aeronautics Company in Fort Worth, Texas.

The department annually releases a report on state tax expenditures. Appendix A contains information from the 2005 State Tax Expenditure Report regarding the usage of the Joint Strike Fight Property and Wage credit.

OTHER STATES' INFORMATION

A review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* tax laws found no comparable tax credits for the JSF program. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 2033, As Introduced Effective On Or After January 1, 2006 Enactment Assumed After June 30, 2006 (\$ Millions)			
Fiscal Year	2006-07	2007-08	2008-09
JSF Credit	-\$4	-\$12	-\$28

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 JSF budget for 2006 is \$2.4 billion. This estimate assumes that 30% of that amount will be spent in California annually and that 40% of spending will be for qualified wages. Because the wage credit is limited to the lesser of 10% of wages or \$10,000 per employee, it is estimated that 9% of wage spending, or \$26 million per year, will be creditable ($\$2.4 \text{ billion} \times 30\% \times 40\% \times 9\% = \26 million).

It is also assumed that 40% of JSF spending will be for qualified investments. The credit rate for these investments is 6%. Thus, investment credits would be approximately \$17 million per year ($\$2.4 \text{ billion} \times 30\% \times 40\% \times 6\% = \17 million).

The JSF credit is restricted to the amount of credit explicitly anticipated in the contract bid and used to reduce the bid price. Since the last bill to extend the sunset date of this credit failed, it is assumed that contracts currently in existence did not anticipate the extension of the credit this bill would provide. Therefore, credits may be claimed only for new contracts or new subcontracts written with the knowledge of the extension of the credit or for old contracts that did not use all of their anticipated credits prior to the extension of the credit. The use of new contracts is phased in over a three year period, and the availability of unused credits from earlier contracts is phased out over a two year period. As a result, total credits generated are estimated to be approximately \$6 million in 2006, rising to \$43 million in 2009. The estimates presented in the table above assume that 20 percent of credits will be carried over for future use and have been converted to fiscal years.

LEGISLATIVE STAFF CONTACT

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Appendix A

Joint Strike Fighter Property and Wage Credits

Description:

The Joint Strike Fighter (JSF) is a new fighter plane. California offers two credits to JSF contractors and subcontractors who reduce their bids on JSF contracts by the amount of the credits. One credit is a credit to employers equal to 10 percent of the cost of certain investments made as part of a contract for production of the JSF or its components. The second credit is a credit to employers for certain wages paid to employees working in California on the JSF project. The credit is equal to 50 percent of wages up to 1½ times the minimum wage for the first year of employment. The credit percentage is reduced by 10 percent each subsequent year of employment. Both credits are scheduled to sunset for taxable years beginning on or after January 1, 2007.

Amount:

Due to delays in the JSF program, no credits had been claimed as of the 2002 tax year. We estimate, however, that the revenue impact of the JSF will be approximately \$10 million for fiscal year 2003-04, and \$35 million for fiscal year 2004-05.

Number of Tax Returns Affected:

Because no credits have yet been claimed, the number of taxpayers who will claim this credit is not known.

Discussion:

The purpose of this credit is to provide an incentive to the federal government to select contractors, and for the contractors to choose subcontractors, that will perform their work on the JSF project in California. To be considered effective, this credit must increase the number of contracts, including Subcontracts, on the JSF project that are awarded to firms that will undertake their JSF work in California. The extent to which the credit will be incorporated into bids for JSF 56 contracts is not yet known. Furthermore, even if any contracts that have been or will be awarded include this credit, it will not be known if the California contractor would have lost its contract to a non-California competitor in the absence of the credit. It should be noted that if, as required by statute, the credit is passed through to the purchaser, the direct benefit from this credit will accrue to the purchaser rather than to the taxpayers that actually claim the credit. There is, however, an administrative burden placed on the taxpayer claiming the credit. One factor that may be inhibiting contractors from incorporating this credit in their bids is that it is nonrefundable. Therefore, taxpayers risk not being able to claim the credit after they have received a contract at a reduced price. This is particularly likely in the case of the property credit. Most property eligible for the JSF property credit is also eligible for the Manufacturer's Investment Credit. These investments may also qualify for Enterprise Zone Credits. Taxpayers who can claim these other credits are less likely to have sufficient tax liability to use their JSF credits.