Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Ashburn	Analyst:	Nicole Kwon	Bill Number:	SB 1001
Related Bills:	See Legislative History	Telephone:	845-7800	Amended Date:	04-04-2005
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Sales Or Use Tax Paid For Qualified Property Used In Targeted Tax Area Credit/Increase PIT Limitation To $10,000,000 & Corporation Limitation To $50,000,000

SUMMARY

This bill would modify the Targeted Tax Area (TTA) sales and use tax credit.

SUMMARY OF AMENDMENTS

The April 4, 2005, amendments increased the personal income tax (PIT) limit on the sales and use tax credit for qualified equipment to $10 million, added limited liability companies (LLCs) to the meaning of qualified taxpayer, and added two co-authors.

The bill as introduced February 22, 2005, increased the qualified property limit for both PIT and corporate income tax.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to expand TTA benefits to further enhance the economy of Tulare County.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2005.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law does not have economic development areas with provisions similar to TTAs. Federal law provides for economic development areas called empowerment zones and enterprise communities, which are eligible to receive two tax incentives: (1) tax-exempt private activity bonds to finance certain facilities; and (2) the "brownsfields" tax incentive, which allows taxpayers to expense (rather than capitalize) certain environmental remediation expenditures. Qualified empowerment zone businesses are allowed an additional $20,000 depreciation expense deduction.

Board Position:			Department Director	Date
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Existing state law, under the Government Code, allows for the designation of a TTA. Using specified criteria regarding unemployment, income levels, poverty levels, and percentages of residents receiving Aid to Families with Dependent Children, Tulare County was designated as a TTA. The designation was made November 1, 1998, and is to remain in effect for 15 years beginning January 1, 1998. This is the only TTA designation made.

Certain taxpayers conducting business activities in a TTA are permitted special tax incentives under the Revenue and Taxation Code. These incentives include a sales or use tax credit for the purchase of qualified property, as defined, used by a qualified taxpayer, as defined, in a TTA. Currently, the credit is for the total cost of qualified property purchased and placed in service in any taxable year. The total costs of qualified property may be in an amount not to exceed $1 million under the Personal Income Tax Law (PITL) and to $20 million under the Corporation Tax Law (CTL).

“Qualified taxpayer” is defined as any person or entity doing business within the TTA. Business would include manufacturing, textiles, freight, transportation, warehousing and storage, and durable and non-durable wholesale goods, as specified by the Standard Industrial Classification (SIC) Manual published by the U.S. Office of Management and Budget, 1987 edition.

The personal income tax law defines “person” to include individuals, fiduciaries, partnerships, limited liability companies, and corporations.

Under federal and state tax law, an LLC may elect to be treated as a corporation or a partnership. An LLC with a single member may be treated as a corporation or disregarded for income tax purposes. When an entity is “disregarded,” its activities are deemed to be the activities of the owner (e.g., a sole proprietorship or a division of a parent company). Under PITL, a tax and fee is imposed on every LLC not classified as a corporation that is organized, registered, or doing business in this state.

Current state law authorizes the creation of a business entity known as an LLC. An LLC consists of one or more members that may be individuals, partnerships, limited partnerships, trusts, estates, associations, corporations, other LLCs, or other business entities. The members of an LLC are afforded limited liability similar to shareholders of a corporation but have pass-through taxes comparable to a partnership.

THIS BILL

This bill would increase the qualified property limitation for the TTA sales and use tax credit from $1 million to $10 million under the PIT and from $20 million to $50 million under the CTL.

This bill would modify the definition of “qualified taxpayer” to include LLCs.

This bill made other nonsubstantive clerical amendments.

IMPLEMENTATION CONSIDERATIONS

It is not clear what the addition of LLCs to the meaning of “qualified taxpayer” is meant to accomplish. The specific addition of LLCs could be interpreted to require LLCs to claim the sales and use tax credit only under the PITL. Thus, prohibiting LLCs from using the larger qualified equipment limit under CTL.

Further, the addition of LLC to the meaning of “qualified taxpayer” results in a number of inconsistencies throughout the rest of the TTA sales and use tax credit provisions. A conversation with the sponsor, upon the request of the author’s office, indicates that the addition of LLC to the meaning of “qualified taxpayer” will be removed.

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 2090 (Reyes, 1999/2000) would have allowed expansion of a TTA by up to 15% and added certain crop preparation services to the lines of businesses that may claim the tax incentives applicable in a TTA. AB 2090 failed to pass out of Assembly Appropriations.

FISCAL IMPACT

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

ECONOMIC IMPACT

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

Estimated Revenue Impact of SB 1001 As Amended April 4, 2005 Effective On Or After January 1, 2005, With Enactment Assumed After June 30, 2005 ($ Millions)			
	2005-06	2006-07	2007-08
PIT	-$4.0	-$3.5	-$3.5
Corp	-$1.5	-$1.5	-$1.5
Total	-$5.5	-$5.0	-$5.0

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

Revenue Discussion:

Current PITL impact for the sales and use tax credit for the TTA is approximately $3 million. Under this bill, the PIT limitation would increase from $1 million to $10 million, and the corporate limitation would increase from $20 million to $50 million. The revenue estimate is based on actual departmental data regarding the current law credit, and a micro simulation model of California tax returns. The above estimate represents only that portion of applied credits with respect to newly generated credits pursuant to this bill. The fiscal year cash flow patterns are based on the department's analysis of how taxpayers adjust their tax payments to reflect the reduction in liability resulting from the previous credit.

LLC are pass-through entities. As such, the impact from LLCs is included in this PIT estimate.

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