

SUMMARY ANALYSIS OF AMENDED BILL

Author: Arambula Analyst: Nicole Kwon Bill Number: AB 1527
 Related Bills: See Prior Analysis Telephone: 845-7800 Amended Date: May 16, 2007
 Attorney: Douglas Powers Sponsor: _____

SUBJECT: California Cleantech Advantage Act Of 2008/Qualified Cleantech Research Expenses Credits

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 23, 2007.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- _____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- _____ FURTHER AMENDMENTS NECESSARY.
- _____ DEPARTMENT POSITION CHANGED TO _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2007, STILL APPLIES.
- _____ OTHER – See comments below.

SUMMARY

This bill would allow a taxpayer a qualified research expense credit relating to the clean technology (cleantech) industry.

SUMMARY OF AMENDMENTS

The May 16, 2007, amendments would make the following changes:

- Eliminate a provision related to qualified cleantech property credit.
- Provide a 20% credit for in-house research conducted in California that is dedicated to the development of cleantech technologies.
- Provide the specified requirements for taxpayers to claim the credit. These requirements include the following:
 1. File an application for the tax credit with the California Council on Science and Technology,
 2. Provide the California Council on Science and Technology with substantiation, and
 3. Provide a copy of the certification issued by the California Council on Science and Technology to the Franchise Tax Board (FTB).

Board Position:	Legislative Director	Date
_____ S	Patrice Gau-Johnson	5/18/07
_____ SA	for Brian Putler	
_____ N		
_____ NA		
_____ O		
_____ OUA		
_____ NP		
_____ NAR		
<input checked="" type="checkbox"/> PENDING		

- Provide the specified requirements for the Director of the California Council on Science and Technology. These requirements include the following:
 1. Allocate tax credits to applicants,
 2. Establish a procedure for qualified taxpayers related to a written application,
 3. Determine and designate a qualified taxpayer,
 4. Process and approve, or reject, all applications on a first-come, first-served basis,
 5. Issue a certificate to the qualified taxpayer,
 6. Promulgate rules and regulations necessary to administer the requirements provided in this bill by December 1, 2008, and
 7. Provide an annual list to the Franchise Tax Board (FTB) containing the names, taxpayer identification numbers, and the total amount of the tax credit allocated to each qualified taxpayer.
- Specify that if the qualified taxpayer fails to retain and provide to FTB the required certification for the credit, the credit would be disallowed.
- Limit the amount of credit to \$1 million per qualified taxpayer per taxable year.
- Limit the aggregate amount of credits in any calendar year to \$50 million.
- Authorize FTB to establish rules and regulations related to provisions of sale of unused credits.

In addition, the May 16, 2007, amendments would define the following terms:

- “Qualified amount” to mean an amount determined in accordance with section 41 of the Internal Revenue Code (IRC) for qualified research conducted in this state.
- “Qualified buyer” to mean any business with 500 or more employees in this state.
- “Qualified research” to mean research certified by the California Council on Science and Technology as cleantech research and meet the additional specified qualifications provided in the bill.
- “Qualified seller” to mean a taxpayer allowed a credit under the provision of this bill.
- “Qualified taxpayer” to mean an applicant who has been allocated tax credits by the California Council on Science and Technology and meet the additional specified qualifications provided in the bill.
- “Cleantech” to mean technologies including, but not limited to, wind, solar, biomass, and hydrogen technologies that result in cleaner air and water, encourage the reuse of materials, and result in reductions of emissions of greenhouse gases.
- “Budget” to mean an estimate of all expenses expected to be paid or incurred during the taxable year.
- “Unused credit” to mean an amount of tax credit originally allowed to a qualified taxpayer that the qualified taxpayer has not claimed against the “net tax.”

As a result of the amendments, revised Implementation Considerations, Technical Considerations, and Economic Impact sections are added below. In addition, the unresolved Policy Concern from the previous analysis is included. Except for the elimination of an analysis

section relating to qualified cleantech property credit, the analysis of the bill as introduced on February 23, 2007, continues to apply.

IMPLEMENTATION CONSIDERATIONS

The bill indicates an aggregate credit allocation amount of \$50 million for each calendar year. Because the bill provides that the credit would be allowed for taxable years beginning on or after January 1, 2008, the bill should be amended to indicate that this amount applies for the 2008 calendar year, and each calendar year thereafter.

The bill is silent on how the credit disallowance provision would coordinate with the sale of the credit. For example, if the seller disposes of the property after it sells the unused credit, would the buyer of the credit be entitled to use the credit even though the credit to the seller has been disallowed? Clarification of this issue is needed to prevent disputes between taxpayers and the department.

The bill does not specify whether the sale of the credit would impact the carry forward period. Without clarification, the department would assume that the remaining credit carryover period for the seller would apply to the purchaser. If this is not the intent, it is possible that a buyer could purchase credit with only three years remaining in its carryover period and possibly either get an extended new period or be limited to the three-year period remaining as if the seller had not sold the credit. Clarification of this issue would prevent disputes between taxpayers and the department.

It is unclear whether the credit may be sold only once or whether the buyer would be allowed to sell it in a subsequent sale to another buyer. The implementation concerns identified with a first sale would be amplified if additional sales were allowed. Clarification of this issue would prevent disputes between taxpayers and the department.

It is unclear what would happen if a taxpayer sells a credit, and the credit is partially or completely disallowed in a subsequent audit by the department. The author may want to consider clarifying whether the seller, purchaser, or both would be liable for any assessments resulting from adjustments to the credit.

The bill is silent on the tax consequence of the sale of the credit to the seller or buyer. Thus, the amount received by the seller on the sale of the credit would normally be included in the seller's gross income under general income tax rules. The bill does not specify how to determine the basis (value) that the credit will have for the buyer. If the author intends that the buyer is to receive a basis in the purchased credit, then it may properly be required to amortize or otherwise recover that basis as the credit is used, and because the credit will more than likely be purchased at some discount to its face amount, the buyer may also be properly required to recognize as income the discount amount over some time period. Disputes may arise between taxpayers and the department as to the proper tax treatment of any consideration paid in connection with the

sale of a credit under this bill. Further, the buyer could claim a deduction for the purchase price of the credit, providing a double tax benefit.

TECHNICAL CONSIDERATION

On page 15, line 32 and page 21, line 16, "Technoloy" should be replaced with "Technology."

POSITION

Pending.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill is estimated to be as shown in the following table:

Estimated Revenue Impact of AB 1527 Effective for tax years BOA 1/1/2008 Enacted after 6/30/2007 (\$ in Millions)				
	2007-08	2008-09	2009-10	2010-11
Cleantech Research Credit	-\$0.5	-\$5	-\$10	-\$15

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

Revenue Discussion

The revenue impact for this bill as amended was estimated as follows. Because cleantech research expenses already qualify for the existing California research credit, the revenue impact of this proposed bill is the excess of cleantech research credit over current research credit. Based on various data sources, including the department's 2004 corporate sample and the 2006 Survey of Current Business, an estimate is made that this excess would be equal to 0.4% of the amount of research credit generated under current law. For the 2008 tax year, the amount of the research credit generated is estimated to be \$2.68 billion. Thus, the impact of this bill would be approximately \$11 million (0.4% x \$2.68 billion). It should be noted that this \$11 million impact is the excess of cleantech research credit over current research credit. The total amount of cleantech research credit generated is higher, \$44 million.

The estimated impact of \$11 million is extrapolated to subsequent tax years based on the projected growth in corporate profits as forecasted by the Department of Finance. The tax year estimates are then converted to fiscal year estimates shown in the table. For example, the

2008-09 cash flow estimate of a revenue loss of \$5 million includes a \$1 million loss for 2008, plus \$4 million loss for 2009 due to higher credit use and reduced estimated tax payments.

LEGAL IMPACT

This bill would require the qualified taxpayer to have its main offices in the state and the qualified buyer to have at least 500 employees in the state to qualify for the credit. This requirement may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

ARGUMENTS/POLICY CONCERNS

IRC section 383, to which California conforms, has stringent requirements regarding the utilization of credit carryovers following any "ownership change" of greater than 5%. These federal rules have evolved over the past 35 years in response to perceived trafficking in credit carryovers by corporations that have acquired corporations for the primary purpose of utilizing the locked credit carryover tax benefits inherent in such corporations. In contrast to that long-standing federal policy, to which California has long conformed, the bill would specifically permit such selling or trading of credit carryovers.

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