Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Corbett	Analyst:	Nicole Kwon	Bill Number:	SB 810
Related Bills:	See Legislative History	Telephone:	845-7800	Amended Date:	April 9, 2007
		Attorney:	Daniel Biedler	Sponsor:	

SUBJECT:	Manufacturers' Investment Credit/Machinery & Equipment Used To Produce Green Vehicles In California

SUMMARY

This bill would create a tax credit for a specified percentage of the costs of qualified property used for manufacturing green vehicles.

SUMMARY OF AMENDMENTS

The April 9, 2007, amendments struck the previous provisions related to public disclosure of tax delinquencies and replaced them with provisions providing a tax credit for manufacturing green vehicles in California.

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to increase the incentive for manufacturers of environmentally-friendly vehicles to remain or locate in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment, but expressly operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Board Position:			Department Director	Date
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Previous state law allowed qualified taxpayers a Manufacturers' Investment Credit (MIC) equal to 6% of the qualified costs paid or incurred on or after January 1, 1994, and before January 1, 2004, for qualified property that was placed in service in California.

For purposes of the MIC, a qualified taxpayer was any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition. Qualified property was any of the following:

1) Tangible personal property that was defined in section 1245(a) of the Internal Revenue Code (IRC) and used in a qualified SIC Code activity, that was used primarily for:
    - manufacturing, processing, refining, fabricating, or recycling of property;
    - research and development;
    - maintenance, repair, measurement, or testing of otherwise qualified property; or
    - pollution control that meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that were an integral part of specified activities.

For taxpayers engaged in computer programming and computer software-related activities, qualified property included computers and computer peripheral equipment used primarily for the development and manufacture of prepackaged software and the value of any capitalized labor costs directly allocable to such property.

The MIC explicitly excluded certain types of property from the definition of qualified property, such as furniture, inventory, and equipment used in an extraction process.

The MIC statute was repealed by its own terms and ceased to be operative as of January 1, 2004, due to the number of manufacturing sector jobs in California falling below the MIC statutory requirements.

<u>THIS BILL</u>

This bill would provide credits for each taxable year beginning on or after January 1, 2007, and before January 1, 2015, based on the following percentage of the qualified costs for manufacturing green vehicles in this state:

- 10% of the qualified costs of the qualified property used to manufacture Level 1 green vehicles.
- 8% of the qualified costs of the qualified property used to manufacture Level 2 green vehicles.
- 6% of the qualified costs of the qualified property used to manufacture Level 3 green vehicles.

This bill would define "qualified cost" to mean any cost that meets <u>all</u> of the following:

1. A cost paid or incurred by the taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2007, and before January 1, 2015.
2. Any amount upon which the taxpayer has paid, directly or indirectly as a separately stated contract amount or as determined from the records of the taxpayer, California sales or use tax.
3. Any capitalized labor costs treated as direct costs of labor under IRC section 263A and that are allocable to the construction or modification of property described in paragraph 1 above.
4. Any amount that is included in the adjusted basis of the qualified property for purposes of computing depreciation or amortization deductions.

This bill would provide special rules for qualified property subject to a lease agreement as follows:

- Only a lessee, and not a lessor, may qualify for the credit;
- Qualified costs on which the credit would be computed would be limited to the lessor's original cost of the qualified property; and
- In the case of successor leases of qualified property, the lessor's original cost would be reduced by the amount of any original cost used in computing the credit for an earlier lease, so that in many circumstances a subsequent lessee would receive no credit.

This bill would define the following types of green vehicles:

- Level 1 would mean a motor vehicle that meets both of the following:
  (1) A plug-in hybrid motor vehicle propelled by an internal combustion engine or heat engine using specified devices, and
  (2) Meets or exceeds either the California super ultra-low-emission vehicle standard and the federal inherently low-emission vehicle or the California advanced technology partial zero-emission vehicle standard and that is rated at 45 miles per gallon or higher highway fuel test procedure.
- Level 2 would mean a motor vehicle that meets any of the following:
  (1) Meets or exceeds the California super ultra-low-emission vehicle standard for exhaust emissions and the federal inherently low-emission vehicle evaporative emission standard,
  (2) Meets or exceeds the California advanced technology partial zero-emission vehicle standard for criteria pollutant emissions and that is rated at 45 miles per gallon or higher highway fuel test procedure, or
  (3) Is a gas-electric hybrid vehicle produced during 2007 model year or earlier and has a combined fuel economy rating of 45 miles per gallon or greater according to federal highway fuel test procedure, and meets California's ultra-low emission vehicle standard for exhaust emissions.
- Level 3 would mean a motor vehicle that meets or exceeds California standards for criteria pollutant emissions and has a combined fuel economy rating of 30 miles per gallon or greater according to the federal highway fuel test procedure.

This bill would define the following terms:

- "Qualified property" means tangible personal property as defined in IRC section 1245(a)(3)(A) and is for use by a qualified taxpayer in a qualified activity.
- "Qualified taxpayer" means any taxpayer engaged in the manufacture of green vehicles.
- "Qualified activity" means manufacturing of green vehicles or component parts thereof.
- "Manufacture" means the activity of converting or conditioning property by changing its form, composition, quality, or character for ultimate sale at retail, including improvements that result in greater service life or greater functionality.
- "Miles per gallon" means the same as used in the federal Fuel Economy Guide.

This bill would specify that "combined miles per gallon" be calculated using 55% of city miles per gallon and 45% of highway miles per gallon.

This bill would provide a carryover provision for unused credits for eight years.

IMPLEMENTATION CONSIDERATIONS

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

TECHINICAL CONSIDERATIONS

On page 4, line 15, "including" should be deleted.

On page 6, line 33, "unrelated" before "party" should be deleted.

LEGISLATIVE HISTORY

AB 2395 (Villines, 2005/2006) would have created a tax credit for purchasers of certain property used in manufacturing. AB 2395 failed passage in the Assembly Revenue and Taxation Committee.

AB 1028 (Horton, 2005/2006) would have created a MIC for manufacturing and processing meat and poultry in California. AB 1028 failed passage in the Assembly Revenue and Taxation Committee.

AB 2076 (Dutton, 2003-2004) would have reinstated the previous MIC only for electric services (power generation, transmission, or distribution). AB 2076 failed passage in the Assembly Revenue and Taxation Committee.

AB 1998 (Dutton, 2003/2004) would have reinstated the previous MIC for taxable years beginning on or after January 1, 2005, and extended the MIC to activities related to electric services. AB 1998 failed passage in the Assembly Revenue and Taxation Committee.

AB 2070 (Houston, 2003/2004) would have reinstated the previous MIC for taxable years beginning on or after January 1, 2005. AB 2070 failed passage in the Assembly Revenue and Taxation Committee.

SB 1295 (Morrow, 2003/2004) would have reinstated the previous MIC for taxable years beginning on or after January 1, 2004, and increased the rate of credit from 6% to 8%. SB 1295 failed passage in the Senate Revenue and Taxation Committee.

SB 676 (Alquist, Ch. 751, Stats. 1994) made clarifying changes to the MIC, and added provisions allowing the credit for leased property, but only to the lessee.

SB 671 (Alquist, Ch. 881, Stats. 1993) enacted the MIC.

OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan,* and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. The survey was limited to income or franchise tax benefits related to manufacturing equipment.

Illinois provides a replacement tax investment credit equal to 0.5% of the basis of qualified property placed in service during the tax year (from July 1, 1984 to January 1, 2004) used by a taxpayer primarily engaged in manufacturing, retailing, coal mining, or fluorite mining.

Massachusetts provides a 3% credit based on the cost of qualified property used for manufacturing, farming, fishing, or research and development.

Michigan provided a credit (from December 31, 2004 and before January 1, 2006) of up to 2% to taxpayers with gross receipts of $10 million or less for newly created high-technology activities or manufacturing jobs.

New York provides an investment tax credit to manufacturers for certain depreciable equipment or buildings. The credit is 5% of up to $350 million of qualified expenditures and 4% for qualified expenditures in excess of $350 million. Certified pollution control, industrial waste treatment, and acid rain control facilities also qualify for this credit. Research and development property may qualify for an optional rate of 9%.

FISCAL IMPACT

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

ECONOMIC IMPACT

The revenue impact of this bill would be determined by the amount of qualified costs incurred for qualified property placed in service in the state and used to manufacture green vehicles, and the amount of credits that can be applied to reduce tax liabilities of taxpayers incurring such costs. Corporation sample data from the department indicates there are approximately 80 corporations doing business in the state with a primary business code related to manufacturing motor vehicles. According to the author's office, only one corporation is currently manufacturing green vehicles. As a result, an estimate of the potential immediate revenue impact of the credit proposed by this bill cannot be released due to disclosure laws that prohibit the department from releasing data that could disclose a specific taxpayer's information.

It is possible the proposed credit would provide sufficient incentive for one or more corporations to re-tool and begin manufacturing green vehicles in this state. Assuming enactment of this bill in late 2007, the earliest any credits due to re-tooling would be applied to reduce tax liabilities would be in 2008-09.

LEGAL IMPACT

This bill would require taxpayers to place qualified property in service in this state to qualify for the credit. This requirement may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

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