Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Budget & Fiscal Review Analyst: Angela Raygoza Bill Number: SB 98

Related Bills: See Prior Analysis telephone: 845-7814 Amended Date: September 6, 2007

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Members Of Apportioning Trade Or Business May Elect To Use Alternative Formula/Motion Picture And Commercial Production Credits/Research Expense Credit/Alternative Incremental Research Credit Conformity/Repeal December 31, 2013

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

_X_ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_X_ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended July 20, 2007.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED July 20, 2007 STILL APPLIES.

_X_ OTHER – See comments below.

SUMMARY

Under the Personal Income Tax and Corporation Tax laws, this bill would do the following:

- Create tax credits based on certain wages paid or amounts paid to purchase or lease certain property used to produce motion pictures or commercials in California.
- Eliminate California Alternative Incremental Research Credit (AIRC) modifications and repeal the Research Expense Credit as of January 1, 2014.
- Re-enact the Research Expense Credit beginning January 1, 2014.

Under the Corporation Tax Law, this bill would do the following:

- Provide an alternative apportionment method for corporations to assign income to California.

This bill would also add provisions to the Sales and Use Tax Law (SUTL). This analysis will not address these changes because they do not impact the department or state income tax revenue.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	9/27/07
____ N	____ OUA	_X_ PENDING		

SUMMARY OF AMENDMENTS

The September 6, 2007, amendments made the following changes:

- Added tax levy language.
- Modified the Research Expense Credit repeal date.
- Added language that would reenact the Research Expense Credit.

As a result of the amendments, the Effective/Operative Date, Summary of Economic Impact, and Research Expense Credit Analysis as provided in the department's analysis of the bill as amended July 20, 2007, have been revised. The remainder of that analysis still applies.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. This bill provides the following operative dates for each of the following provisions:

- Motion Picture and Commercial Production Credits: This provision would be operative for taxable years beginning on or after January 1, 2008, and before January 1, 2014. By its terms, the provisions would be repealed on January 1, 2014. The bill also specifies that the amount upon which the motion picture credit is based does not include any qualified wages paid or incurred for services performed or any qualified property purchased or leased before January 1, 2008. In addition, the bill specifies that qualified production costs for a qualified commercial do not include costs for story, script, or scenario to be used for a qualified commercial or qualified wages paid or incurred before January 1, 2008.
- Research Credit: This provision would be operative for taxable years beginning on or after January 1, 2008, and the credit would be repealed on January 1, 2014. The credit—in the same form as it is under current law—would be reenacted and operative for taxable years beginning on and after January 1, 2014.
- Apportionment Method: This provision would be operative for taxable years beginning on or after January 1, 2009, and before January 1, 2014, and repealed on December 1, 2014. Current law would be operative again for taxable years beginning on and after January 1, 2014.

POSITION

Pending.

SUMMARY OF ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 98 Effective for Taxable Years BOA January 1, 2008 Assumes Immediate Enactment ($ in Millions)				
	2007/08	2008/09	2009/10	2010/11
Motion Picture/Commercial Production Credits	− $5	− $40	− $70	− $90
Research Credit	/a	− $5	− $5	− $5
Apportionment Formula	None	– $55	– $255	– $475
Total Revenue Impact of this Bill	– $5	– $100	– $330	– $570

/a: Revenue loss of less than $1 million.

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 revenue impact of this proposed bill was estimated as follows:

Motion Picture/Commercial Production Credits

The impact of both the motion picture and the commercial production tax credits is dependent on the amount of qualified wages and qualified tangible personal property purchased or leased and the portion of the allocated credit that is used to reduce tax liabilities.

Based on employment data for the film/video production industry in California and adjusting for tangible personal property, total credits for qualified wages and property are anticipated to exceed the combined annual credit cap of $75 million.

The $75 million of allocated credits are adjusted for the following reasons:

- Projects are completed, on average, over a three-year period,
- Projects approved by the California Film Commission (CFC) are subsequently abandoned and therefore credits would be reallocated in later years, and
- Allow time for the Commission to establish the approval process.

Credits generated for the 2008 taxable year are projected to be $60 million derived as follows:

$75 million in credits x 80% (percentage of films that begin production in 2008 or before and are completed in 2008, adjusted for films that a credit is allocated in 2008, but which is subsequently abandoned and therefore must be reallocated in later years).

Unused credits may be carried over for six years. A qualified taxpayer may sell their credits attributable to an independent film or commercial production, as defined, to an unrelated party. Therefore, it is assumed that of the combined $60 million credits generated during 2008, on average, taxpayers will use 81% or $49 million of these credits, leaving carryover credits of $11 million ($60 million - $49 million). It is assumed that carryover credits will be used, on average, over two years.

Research Credit

The impact of higher AIRC research credit rates on corporate returns was estimated through simulations using the 2005 sample of corporate returns. These simulations took into account corporations' generation of research credit, other credit availability including credit carryovers from prior tax years, and tax liability. It was assumed that due to higher AIRC research credit rates, some taxpayers would switch from regular research credit to AIRC instead and there would be an increase in the number of taxpayers claiming AIRC research credit. The impact of higher AIRC research credit rates on individual returns was assumed to be equal to 5% of the impact on corporate returns.

This provision repeals the higher AIRC research credit rates after January 1, 2014. After this date, AIRC research credit rates under current law would apply, and the generation of additional research credits due to higher AIRC rates would stop. However, the use of research credit carried over from prior years would continue. The revenue impact of this increased use of carried-over research credit is estimated to be approximately $3 million a year.

Apportionment Method

The impact of higher sales-factor weights was simulated using samples of corporate tax returns for the tax years 2003, 2004, and 2005. The simulations accounted for the taxpayers' specific financial situation as reported on their tax returns. These tax amounts were compared with the tax amount calculated under current law. It was assumed that a taxpayer would choose the apportionment formula that yields the lowest tax. The revenue impact of this provision for the 2005 tax year was estimated as the average amount of tax reduction of these tax years. The language of this provision is not clear on the issue of whether or not members of an apportioning trade or business may make separate elections for the alternative apportionment method. The above estimates assume no separate elections. However, if the members are allowed to make separate elections the revenue losses would be higher: -$0, -$70 million, -$320 million, -$600 million for the tax years 2007/2008 to 2010/2011, respectively.

Assumptions and Fiscal Year Estimates

The estimated 2005 revenue impact for the above three provisions were extrapolated to future years. This extrapolation took into account the growth of the taxpayers' income and the assumption that higher sales-factor weights would yield larger tax savings in subsequent years as the sales-factor weights are accumulated each year. It was assumed that taxpayers' income would grow at the same growth rate as corporate profits as forecasted by the Department of Finance.

Finally, the tax year estimates of the above three provisions were converted to fiscal year estimates shown in the table. For example, the 2009/2010 cash flow estimates of the revenue loss for the above three provisions are $70 million, $5 million, and $255 million, respectively, for a total revenue loss of $330 million. This $330 million loss includes a $115 million loss from the 2009 tax year plus $215 million loss from the 2010 tax year due to higher credit use and reduced estimated tax payments.

RESEARCH EXPENSE CREDIT

ANALYSIS

THIS PROVISION

This provision would amend California's modified adoption of the AIRC rates by removing those modifications for taxable years beginning on or after January 1, 2008, which would result in conformity with the federal AIRC provisions until this conformity to federal law is repealed on January 1, 2014.

This bill would also add language to reenact the research credit as it exists under current California law for taxable years beginning on or after January 1, 2014.

TECHNICAL CONCERNS

The bill would allow the Research Expense Credit to be claimed for taxable years beginning on or after January 1, 2008, and before January 1, 2014. Therefore, the last fiscal year that a credit would be allowed would be for the period beginning December 1, 2013, and ending on November 30, 2013. However, in the bill under the personal income tax and corporation tax law, the Research Expense Credit repeal date is January 1, 2014, eleven months before the end of the last taxable year the credit is allowed. The author may wish to amend the bill to revise the repeal date to December 1, 2014, to include the last fiscal year.

LEGISLATIVE STAFF CONTACT

Angela Raygoza
Franchise Tax Board
(916) 845-7814
angela.raygoza@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov