Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Ashburn Analyst: Jahna Alvarado Bill Number: SB 1074

Related Bills: See Prior Analysis Telephone: 845-5683 Amended Date: May 3, 2010

Attorney: Patrick Kusiak Sponsor: ____

SUBJECT: Manufacturer's Investment Credit/6 Percent Of Cost Of Qualified Property Used In Green Technology & Renewable Energy Resources Business

____ 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 ALL OF THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 17, 2010.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 17, 2010, STILL APPLIES.

X OTHER – See comments below.

SUMMARY

This bill would create an income and franchise tax credit for taxpayers engaged in green technology and renewable energy resources activities, as specified.

SUMMARY OF AMENDMENTS

The May 3, 2010, amendments resolved one of the technical considerations identified in the department's analysis of this bill as introduced February 17, 2010, identified an additional implementation concern, and would delay the allowance of the credit provided by this bill until taxable years beginning on or after January 1, 2014, as specified.

Except for the "This Bill," "Implementation Considerations," "Technical Considerations," and "Economic Impact" sections, the department's analysis of this bill as introduced February 17, 2010, still applies.

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau-Johnson	05/12/10
____ N	____ OUA	X PENDING		

THIS BILL

This bill would allow a credit for taxable years beginning on or after January 1, 2010, of 6 percent of the qualified cost paid or incurred on or after January 1, 2010, by a qualified taxpayer for qualified property placed in service in this state during the year. The language in this bill for the proposed credit is substantially similar to the prior MIC law.

Any credit allowable by this bill for taxable years beginning on or after January 1, 2010, and before January 1, 2014, would be allowed as a credit only for the first taxable year beginning on or after January 1, 2014.

This bill would define "qualified cost" as any cost that is all of the following:

- A cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition, or lease, of qualified property on or after January 1, 2010,
- An amount that the qualified taxpayer has paid sales or use tax on, and
- An amount that is properly chargeable to the capital account of the qualified taxpayer.

This bill would define "qualified taxpayer" as any taxpayer that is primarily engaged in any of the following activities:

- Green technology that is either consistent with meeting the goals and objectives of green house gas emissions standards or promotes the reduction of wasteful, inefficient, unnecessary, or uneconomic uses of energy;
- Production of products, systems, or management of cost-effective water use efficiency practices to curtail the waste of water and to ensure that water use does not exceed reasonable needs;
- Production of products, systems, or management of the utilization of recycled or reusable materials in the manufacturing process;
- Production or application of cogeneration technology, as defined;
- Production of products, systems, or management of the conservation of energy; or
- Production of products, systems, management, or the use of solar, biomass, wind, geothermal, hydroelectric under 30 megawatts, or any other source of energy, that would reduce the use of fossil and nuclear fuels.

This bill would define a pass through entity as any partnership or S corporation and would specify that the determination of whether a pass through entity is a "qualified taxpayer" would be made at the entity level and any credit passed through to the partners or shareholders, as specified.

This bill would define "qualified property" as property that is any of the following:

- Tangible personal property as defined in IRC section 1245(a) that is used by a qualified taxpayer for any of the following:
    - The manufacturing, processing, refining, fabricating, or recycling of property;
    - In research and development;
    - To maintain, repair, measure, or test property, as specified;
    - For pollution control that meets or exceeds standards as specified; or
    - For recycling.
- Computers and computer peripheral equipment used by a qualified taxpayer that is primarily used to develop or manufacture the following:
    - Cogeneration technology;
    - Technology or products for the conservation of energy;
    - Technology or products for the use of solar, biomass, wine, geothermal; hydroelectricity under 30 megawatts; or
    - Any other source of energy that would reduce the use of fossil and nuclear fuels.
- Capitalized labor costs directly allocable to the construction or modification of qualified property, as defined.
- Special purpose buildings and foundations.
- Computer software that is used primarily for a green technology or renewable energy resources activity, as defined by this bill.

This bill would specifically exclude the following from the definition of "qualified property":

- Furniture;
- Facilities used for warehousing purposes after completion of the manufacturing process;
- Inventory;
- Equipment used in the extraction process;
- Equipment used to store finished products that have completed the manufacturing process; and
- Any tangible personal property that is used in administration, general management; or marketing.

This bill would allow the credit for "qualified property" acquired by or subject to lease by a "qualified taxpayer" as specified.

This bill would require a lessor of "qualified property" to provide a statement to the lessee that includes the lessor's original cost for the "qualified property" and the amount of the cost that sales or use tax had been paid on as specified. Additionally, this bill would require that the statement be made available to the Franchise Tax Board (FTB) upon request.

This bill would define a number of terms, including "fabricating," "manufacturing," "primarily," "process," "processing," "refining," "research and development," "special purpose building and foundation," and "small business."

This bill would disallow this credit if in the same taxable year that the "qualified property" is first placed into service, the "qualified property" is:

- Removed from the state,
- Disposed of to an unrelated party, or
- Used for a purpose that does not qualify for the credit.

This bill would require that the credit be recaptured if, within one year from the date that the "qualified property" is first placed into service, the "qualified property" is:

- Removed from the state,
- Disposed of to an unrelated party, or
- Used for a purpose that does not qualify for the credit.

This credit would be eligible for assignment among members of a unitary group as specified.

The bill would provide a carryover provision for any unused credit for seven years, or nine years in the case of a "small business", as defined, or until the credit is exhausted, whichever is shorter.

This bill would allow FTB to prescribe appropriate regulations to carry out the purpose of this bill, including any regulations necessary to prevent the avoidance of the application of the effect this bill would have through split-ups, shell corporations, partnerships, tiered ownership structures, or otherwise.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill would allow an investment credit for property that is primarily used in the state for specified green technology, resource conservation, or alternative energy activities. The department lacks expertise in these areas. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. The taxpayer could then be required to provide this certification to the department upon request. For example, the State Air Resources Board could serve as the certifying agency for research that is "consistent with meeting the goals and objectives of compliance with greenhouse gas emissions standards as set forth in the Health and Safety Code."

This bill would allow a credit to "qualified taxpayers," and would define this term as taxpayers that are "primarily engaged" in specified green activities, (i.e., "the production, of products, systems, or management of cost-effective water use efficiency practices to curtail the waste of water and ensure that water use does not exceed reasonable needs."). Because the activities are undefined, it is unclear how a taxpayer's eligibility for this credit would be determined and could lead to disputes between taxpayers and the department. The author may wish to amend this bill to clarify the business activities that would qualify for the credit. For example, under the prior MIC, a qualified taxpayer was any taxpayer engaged in manufacturing activities described in specified codes listed in the SIC Manual, 1987 edition.

This bill uses terms and phrases that are undefined, (e.g., "computer software," "consistent with meeting," "efficiency practices," "management," "primarily engaged," "promotes the reduction of wasteful, inefficient, unnecessary, or uneconomic uses of energy"). The absence of definitions to clarify these terms could lead to disputes between taxpayers and the department, thus complicating the administration of this credit. The author may wish to amend this bill for clarity, and to the extent these terms have been defined in the MIC regulation,[1] the author may wish to use existing definitions.

Because the definition of qualified property fails to require that property be used for specified green activities, this bill would allow a credit for all qualified property purchased by a taxpayer that is a qualified taxpayer. If it is the author's intention to limit the credit to qualified property used in a specified green activity, this bill should be amended.

This bill would limit the use of the credit generated in taxable years beginning on or after January 1, 2010, and before January 1, 2014, to the first taxable year beginning on or after January 1, 2014. If it is the author's intention to allow any excess credit to be carried forward, it is recommended that this bill be amended to eliminate the word "only" as it applies to this provision.

[1] Cal. Code Regs., tit. 18, §§ 17053.49-2, sub. (i), & 23649-2, sub. (i).

TECHNICAL CONSIDERATIONS

Subdivision (d), paragraphs (1) and (2), of the Personal Income Tax Law and Corporate Tax Law provisions should be amended where the term "Section 1245(a)" appears, as it should be "Section 1245(a)(3)(A)" to correspond to the definition of "tangible personal property" in the Internal Revenue Code.

ECONOMIC IMPACT

Revenue Estimate

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

Estimated Revenue Impact of SB 1074 MIC for Green Technology and Renewable Energy Activities. Operative for Taxable Years Beginning On or After January 1, 2010 Enactment After September 30, 2010 ($ in Millions)				
2010-11	2011-12	2012-13	2013-14	2014-15
$0	$0	$0	-$85	-$170

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

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