Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Corbett	Analyst:	Jahna Alvarado	Bill Number:	SBX3 55
Related Bills:	See Legislative History	Telephone:	845-5683	Introduced Date:	September 11, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Automobile Manufacturing Retention Tax Credit

SUMMARY

This bill would create a tax credit under the Corporation Tax Law (CTL) for automobile manufacturing 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 automobiles to remain or locate in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and specifically applicable to taxable years beginning on or after January 1, 2010.

POSITION

Pending.

SUMMARY OF SUGGESTED AMENDMENTS

Department staff is available to assist with amendments to resolve the implementation, technical, and policy concerns discussed in this analysis.

An amendment is suggested to delete unnecessary language.

ANALYSIS

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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FEDERAL LAW

As of February 18, 2009, federal law allows a credit for qualified investments, as specified, in a qualified advanced energy manufacturing project (QAEMP) as certified by the Secretary of the Treasury. The credit is equal to 30 percent of the qualified investment, as specified during the taxable year. For purposes of the QAEMP, qualifying projects include projects that re-equip, expand, or establish a manufacturing facility for the production of new qualified plug-in electric drive motor vehicles, qualified plug-in electric vehicles, or components designed specifically for use with these vehicles.

The total amount of credits that may be allocated under the QAEMP program is limited to $2.3 billion.

STATE LAW

Previous state law allowed qualified taxpayers a Manufacturers' Investment Credit (MIC) equal to 6 percent 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.

THIS BILL

This bill would allow a qualified taxpayer, upon election, a credit for taxable years beginning on or after January 1, 2010, based on the following percentage of the qualified expenditures for automobile manufacturing in this state:

- 30 percent of the qualified expenditures paid or incurred by a qualified employer with an average annual employment volume of 4,000 or more qualified employees.
- 25 percent of the qualified expenditures paid or incurred by a qualified employer with an average annual employment volume of at least 3,900 but not more than 3,999 qualified employees.
- 20 percent of the qualified expenditures paid or incurred by a qualified employer with an average annual employment volume of at least 3,800 but not more than 3,899 qualified employees.
- 15 percent of the qualified expenditures paid or incurred by a qualified employer with an average annual employment volume of at least 3,700 but not more than 3,799 qualified employees.
- 10 percent of the qualified expenditures paid or incurred by a qualified employer with an average annual employment volume of at least 3,600 but not more than 3,699 qualified employees.
- 5 percent of the qualified expenditures paid or incurred by a qualified employer with an average annual employment volume of at least 3,500 but not more than 3,599 qualified employees.

To qualify for the credit for taxable years beginning on or after January 1, 2010, and before January 1, 2013, a taxpayer would be required to meet the definition of "qualified taxpayer" for both the taxable year the credit would be claimed and the taxpayer's first taxable year beginning on or after January 1, 2013.

For taxable years beginning on or after January 1, 2010, and before January 1, 2013, a qualifying taxpayer would elect the credit by filing an amended return with the Franchise Tax Board on or after January 1, 2013, for each tax year the credit is claimed. A qualifying taxpayer's failure to file an amended return as specified would be deemed to be an election out of the credit.

For taxable years beginning on or after January 1, 2013, a qualifying taxpayer would elect the credit by reporting the credit this bill would allow on a timely filed original return.

This bill would define "qualified taxpayer" as a taxpayer engaged in automobile manufacturing in California that employs an average of 3,500 or more qualified employees, as determined on an annual basis.

Under the provisions of this bill, the average number of qualified employees employed by a taxpayer during the taxable year would be calculated by dividing the total number of hours that the taxpayer paid wages to qualified employees during the taxable year by 2,000. For purposes of this calculation, full-time salaried qualified employees would be treated as being paid for 40 hours per week. In the case of a taxable year less than twelve months, 2,000 would be reduced by the fraction that is the number of months in the short taxable year divided by twelve.

This bill would define "qualified expenditures" as amounts paid or incurred to:

- Purchase or lease qualified property used within this state for the manufacture of automobiles, and
- Pay qualified wages for services performed in California for the manufacture of automobiles.

This bill would define "qualified property" as:

1. Tangible personal property used by a qualified taxpayer that is primarily used for:
    - The manufacture of automobiles in California,
    - The maintenance, repair, measurement, or testing of other qualified property, as defined,
    - Pollution control that meets or exceeds state, local, or regional standards,
    - Recycling.
2. The value of capitalized labor costs, that are not qualified wages, incurred for the construction or modification of qualified property.
3. Special purpose buildings and foundations, as specified that are constructed or modified for use by the qualified taxpayer primarily in the manufacture of automobiles.
4. Computer software that is primarily used to operate tangible personal property, as defined.

This bill would define "qualified wages" as wages required to be reported under Section 13050 of the Unemployment Insurance Code that are not wages related to financing, overhead, marketing, distribution, or sales of completed automobiles.

This bill would define "qualified employee" as any individual employed by a qualified taxpayer who performs services for the qualified taxpayer at an automobile manufacturing plant during the taxable year whose wages are subject to reporting under Section 13050 of the Unemployment Insurance Code.

This bill would define "automobile manufacturing" as the manufacture of new vehicles as defined in Section 430 of the Vehicle Code that are passenger vehicles as defined in Section 465 of the Vehicle Code.

The credit for purchases of qualified property allowed by this bill would be subject to recapture if the qualified property is removed from the state, disposed of, or used for a non-qualifying purpose within one year from the date the qualified property is first placed in service.

This bill would allow any unused credit to be carried over until exhausted.

The credit that would be allowed under this bill would not be subject to assignment.[1]

This bill specifies that no deduction would be allowed for the same expenses for which the credit was allowed.

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 does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

The definition of "qualified taxpayer" is unclear and could include manufacturers of component parts and assemblies used in the assembly of completed automobiles. If it is the author's intent that this credit would be limited to manufacturers of completed automobiles, the author may wish to amend this bill.

This bill is silent on the deadline for a taxpayer to file an amended return claiming the credit. Assuming that an amended return claiming the credit is considered a claim for refund or credit, the standard statute of limitations barring refunds or credits would apply.[2] If it is the author's intent to specify a different filing deadline for the amended returns, the author may wish to amend this bill.

TECHNICAL CONSIDERATIONS

The term "the" used in the phrase "the automobile manufacturing" in subparagraph (A) of paragraph (3) of subdivision (c) is unnecessary. Amendment 1 is provided to delete this unnecessary language.

LEGISLATIVE HISTORY

SB 483 (Corbett, 2009/2010) would have created a tax credit under the CTL for automobile manufacturing in California that is identical to the credit that this bill would create. SB 483 failed passage in the Assembly Rules Committee.

SB 810 (Corbett, 2007/2008) would have created a MIC for manufacturing "green" vehicles in California. SB 810 failed passage in the Senate Revenue and Taxation Committee.

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[1] Revenue and Taxation Code section 23663 allows for an irrevocable assignment of certain credits as specified to taxpayers that are members of a combined reporting group.
[2] The statute of limitations for filing a claim for refund is the later of: four years from the date of a timely filed return, four years from the original due date of the return, or one year from the date of overpayment. (Revenue and Taxation Code section 19306.)

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 percent to 8 percent. 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 *Florida, 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 includes income or franchise tax benefits related to investment in manufacturing equipment and expanding employment.

Florida provides a capital investment credit of 5 percent of eligible capital costs generated by a qualifying project in a high impact sector. The credit may be claimed for a period of up to 20 years beginning with the commencement of operations of the project. High impact sectors include the aviation, aerospace, automotive, and silicon technology industries.

Illinois provides a replacement tax investment credit and an Economic Development for a Growing Economy (EDGE) credit. The replacement tax investment credit is equal to 0.5 percent of the basis of qualified property placed in service during the tax year that is used by a taxpayer primarily engaged in manufacturing, retailing, coal mining, or fluorite mining. The EDGE credit is available to businesses creating new jobs in *Illinois.* The amount of the EDGE credit is determined by agreement between the *Illinois* Department of Revenue and the taxpayer. To qualify for the EDGE credit a taxpayer must be in the manufacturing, processing, assembling, warehousing, distributing, research and development, or tourism services business in the state of *Illinois*.

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

Michigan provides a combined compensation and investment tax credit of up to 52 percent of the total Michigan Business Tax (MBT) tax liability before the imposition and levy of the annual MBT surcharge for tax years 2009 and later.

New York provides an investment tax credit to manufacturers for certain depreciable equipment or buildings. The credit is 4 percent for qualified expenditures. Research and development property may qualify for an optional rate of 7 percent. Additionally, a taxpayer qualified to take the investment tax credit may also be eligible for an employee incentive tax credit of up to 2.5 percent of the investment credit base if the average number of employees during the taxable year is at least 101 percent of the average number of employees during the employment base year.

FISCAL IMPACT

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.

ECONOMIC IMPACT

<u>Revenue Discussion</u>

Because the number of affected taxpayers is too small, the department's disclosure rules prohibit us from providing an estimated revenue impact for this bill. The following discussion is provided to illustrate the potential revenue impact.

This discussion assumes that the credit would be limited to only those qualified taxpayers who manufacture new passenger vehicles and would not be allowed to an automobile manufacturer of non-passenger vehicles (e.g. delivery trucks, tow-trucks).

For purposes of this discussion, it is assumed that an automobile manufacturer is a qualified taxpayer that purchased $5 million in qualifying property during the taxable year and employed an annual average of 5,000 qualified employees with each employee earning approximately $60,000 per year. The qualified expenditures that the credit would be based on would be approximately $305 million [(5,000 employees x $60,000) + $5 million ≈ $305 million]. Because the taxpayer's annual average employment exceeds 4,000, the credit would be calculated as 30 percent of the qualified expenditures. Thus, the total credits generated by the qualified taxpayer under these assumptions, could be as much as approximately $91.5 million a year ($305 million x 30% ≈ $91.5 million). Because the credit generated exceeds the maximum that can be reported for a taxable year, the credit that would be claimed under these assumptions would be limited to $10 million for the taxable year.

The actual usage of the credits generated would depend on specific tax attributes of the qualified taxpayer.

Under this proposal, taxpayers generating credits prior to 2013 are required to be qualifying taxpayers for 2013 to claim the credit for the prior taxable years and would claim the credit on an amended return filed with the department on or after January 1, 2013.

ARGUMENTS/POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of tax credits by the Legislature.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SBX3 55
AS INTRODUCED SEPTEMBER 11, 2009

AMENDMENT 1

On page 3, line 28, strikeout "the automobile manufacturing" and insert:

automobile manufacturing