

SUMMARY ANALYSIS OF AMENDED BILL

Author: Dutton, et al. Analyst: Jahna Alvarado Bill Number: SBX6 9
 Related Bills: See Prior Analyses Telephone: 845-5683 Amended Date: June 7, 2010
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Research Expenses Credit/20 Percent Of Excess Qualified Expenses/Conformity To Election of Alternative Simplified Credit

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

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the
 previous analysis of bill as amended May 5, 2010.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _____.

_____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED
 May 5, 2010, STILL APPLIES.

OTHER – See comments below.

SUMMARY

This bill would modify the credit for research expenses.

SUMMARY OF AMENDMENTS

The June 7, 2010, amendments would eliminate the election to use the alternative incremental method (AIC) from the calculation of the research credit and would instead allow an election to use the alternative simplified method (ASC).

Except for the “This Bill,” “Technical Considerations,” and “Economic Impact” sections, the department’s analysis of this bill as amended May 5, 2010, still applies.

Summary of Suggested Amendments

The recent enactment of SB 401 (Stats. 2010, Ch. 14) raises a technical consideration; amendments 1 and 2 are provided to resolve this concern.

Board Position:	Asst. Legislative Director	Date
_____ S		
_____ SA		
_____ N		
_____ NA		
_____ O		
_____ OUA		
_____ NP		
_____ NAR		
<input checked="" type="checkbox"/> PENDING	Patrice Gau-Johnson	7/9/10

THIS BILL

Under the Personal Income Tax Law and the Corporation Tax Law, this bill would, for taxable years beginning on or after January 1, 2010:

- Increase the credit for increasing qualified research expenses from 15 percent to 20 percent;
- Eliminate the election to use the AIC method; and
- Allow a taxpayer to elect to use the ASC method.

Additionally, as a result of the state’s general conformity date change, this bill would, as of January 1, 2011, for taxable years beginning on or after January 1, 2010:

- Allow a credit for 20 percent of the amount paid to an energy research consortium for energy research;
- Modify the definition of “qualified research expenses” to include amounts paid to eligible small businesses, universities, and Federal laboratories, as defined; and
- Define “energy research consortium” by reference to the federal definition.

TECHNICAL CONSIDERATIONS

Effective January 1, 2011, the state’s general conformity date will change to January 1, 2009. As a result of this change, several code section references would refer to an incorrect Internal Revenue Code (IRC) section, and would chapter out changes made by SB 401 (Stats. 2010, Ch. 14) that modify the state’s conformity to the federal research credit. The author may wish to amend this bill to maintain the accuracy of the IRC references and preserve the modifications to federal conformity made by SB 401 that this bill is silent on. Amendments are provided.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of SBX6 9 As Amended June 7, 2010 Operative For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed by September 30, 2010 (\$ in Millions)				
	2010-11	2011-12	2012-13	2013-14
Total revenue impact	-\$165	-\$150	-\$140	-\$140

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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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SBX6 9
AS AMENDED June 7, 2010

AMENDMENT 1

On page 4, after line 20, insert:

SEC. 1.5. Section 17052.12 of the Revenue and Taxation Code is amended to read:

17052.12. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the "net tax" (as defined by Section 17039) for the taxable year an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each taxable year beginning before January 1, 1997, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "8 percent."

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "11 percent."

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "12 percent."

(3) For each taxable year beginning on or after January 1, 2000, and before January 1, 2010, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "15 percent."

(4) For each taxable year beginning on or after January 1, 2010, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code shall apply.

(c) Section 41(a)(2) of the Internal Revenue Code, relating to basic research payments, shall not apply.

(d) "Qualified research" shall include only research conducted in California.

(e) In the case where the credit allowed under this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.

(f) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of "qualified research expense" any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax under Section 6378.

(2) For each taxable year beginning on or after January 1, 1998, the reference to "Section 501(a)" in Section 41(b)(3)(C) of the Internal Revenue

Code, relating to contract research expenses, is modified to read "this part or Part 11 (commencing with Section 23001)."

(g) (1) For each taxable year beginning on or after January 1, 2000, and before January 1, 2010:

(A) The reference to "2.65 percent" in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read "one and forty-nine hundredths of one percent."

(B) The reference to "3.2 percent" in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read "one and ninety-eight hundredths of one percent."

(C) The reference to "3.75 percent" in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read "two and forty-eight hundredths of one percent."

(2) For each taxable year beginning on or after January 1, 2010, Section 41(c)(5) of the Internal Revenue Code, ~~as amended by Public Law 109-432~~, relating to the election of the alternative simplified credit, shall apply.

(3) Section ~~41(c)(6)~~41(c)(7) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(h) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(i) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (e); except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

(j) Section 41(a)(3) of the Internal Revenue Code shall not apply.

(k) Section 41(b)(3)(D) of the Internal Revenue Code, relating to amounts paid to eligible small businesses, universities, and federal laboratories, shall not apply.

(l) Section 41(f)(6), relating to energy research consortium, shall not apply.

AMENDMENT 2

On page 8, after line 13, insert:

SEC. 2.5. Section 23609 of the Revenue and Taxation Code is amended to read:

23609. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the "tax" (as defined by Section 23036) an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each taxable year beginning before January 1, 1997, both of the following modifications shall apply:

(1) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "8 percent."

(2) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "12 percent."

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, both of the following modifications shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "11 percent."

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, both of the following shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "12 percent."

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(3) For each taxable year beginning on or after January 1, 2000, and before January 1, 2010, both of the following shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "15 percent."

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(4) For each taxable year beginning on or after January 1, 2010, both of the following shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code shall apply.

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(c) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of "qualified research expense" any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax under Section 6378.

(2) "Qualified research" and "basic research" shall include only research conducted in California.

(d) The provisions of Section 41(e)(7)(A) of the Internal Revenue Code, shall be modified so that "basic research," for purposes of this section, includes any basic or applied research including scientific inquiry or original investigation for the advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except that the term does not include any of the following:

(1) Basic research conducted outside California.

(2) Basic research in the social sciences, arts, or humanities.

(3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.

(4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(e) (1) In the case of a taxpayer engaged in any biopharmaceutical research activities that are described in codes 2833 to 2836, inclusive, or any research activities that are described in codes 3826, 3829, or 3841 to 3845,

inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, or any other biotechnology research and development activities, the provisions of Section 41(e) (6) of the Internal Revenue Code shall be modified to include both of the following:

(A) A qualified organization as described in Section 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an institution of higher education as described in Section 3304(f) of the Internal Revenue Code.

(B) A charitable research hospital owned by an organization that is described in Section 501(c)(3) of the Internal Revenue Code, is exempt from taxation under Section 501(a) of the Internal Revenue Code, is not a private foundation, is designated a "specialized laboratory cancer center," and has received Clinical Cancer Research Center status from the National Cancer Institute.

(2) For purposes of this subdivision:

(A) "Biopharmaceutical research activities" means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.

(B) "Other biotechnology research and development activities" means research and development activities consisting of the application of recombinant DNA technology to produce commercial products, as well as research and development activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(f) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.

(g) For each taxable year beginning on or after January 1, 1998, the reference to "Section 501(a)" in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read "this part or Part 10 (commencing with Section 17001)."

(h)(1) For each taxable year beginning on or after January 1, 2000, and before January 1, 2010:

(A) The reference to "2.65 percent" in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read "one and forty-nine hundredths of one percent."

(B) The reference to "3.2 percent" in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read "one and ninety-eight hundredths of one percent."

(C) The reference to "3.75 percent" in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read "two and forty-eight hundredths of one percent."

(2) For each taxable year beginning on or after January 1, 2010, Section 41(c)(5) of the Internal Revenue Code, ~~as amended by Public Law 109-432,~~ relating to the alternative simplified credit, shall apply.

(3) Section ~~41(e)(6)~~41(c)(7) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a

purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(i) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(j) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (f), except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

(k) Section 41(a)(3) of the Internal Revenue Code shall not apply.

(l) Section 41(b)(3)(D) of the Internal Revenue Code, relating to amounts paid to eligible small businesses, universities, and federal laboratories, shall not apply.

(m) Section 41(f)(6) of the Internal Revenue Code, relating to energy research consortium, shall not apply.

SEC. 2.6. Sections 1 and 2 of this bill shall be operative for taxable years beginning on or after January 1, 2010, and before January 1, 2011, and are repealed as of January 1, 2011. Section 1.5 and section 2.5 of this bill shall become operative as of January 1, 2011.