Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Perea and Beall   Analyst: David Scott   Bill Number: AB 1818

Related Bills: None   Telephone: 845-5806   Amended Date: May 17, 2012

Attorney: Patrick Kusiak   Sponsor:

SUBJECT: Royalties Paid For Patent Credit

SUMMARY

This bill would create a tax credit for taxpayers that pay royalties for a patent owned by the University of California and commercialize the patent in California.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The May 17, 2012, amendments resolved the department's prior implementation considerations by setting the credit rate at 15 percent, clarifying several definitions, and adding specific time frames for commercializing the patent and for the credit carryover period. As a result of the amendments, a new implementation consideration has been identified. Except for the "This Bill", the "Implementation Considerations", "Support and Opposition", and the "Economic Impact" discussions, the department's analysis of the bill as amended March 29, 2012, still applies. The "Effective/Operative Date", "Fiscal Impact", "Arguments", and "Policy Concerns" discussions are provided for convenience.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2012.

ANALYSIS

THIS BILL

For taxable years beginning on and after January 1, 2012, this bill would create a tax credit in an amount equal to 15 percent of the qualified royalties paid by a qualified taxpayer during the taxable year.

Board Position:			Legislative Director	Date
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This bill would define "qualified taxpayer" as a taxpayer that pays qualified royalties for the use of the patent and commercializes the patented invention in California for at least five years.

"Qualified royalties" would be defined as royalties paid, as a result of a license agreement, with the University of California, or other entity, for use of a "qualified patent."

The bill would also define the following terms:

- "Commercialize" as the process in which the taxpayer uses the patent in the manufacturing, production, growing, or extraction process for commercial purposes.
- "Qualified patent" as a patent owned by the University of California and the research and development costs to create the patent was funded by costs that qualify for the California R&D credit.
- "Qualified research" as having the same meaning as defined in Section 41(d) of the Internal Revenue Code, as modified for California purposes.

This bill would specify that any unused credits could be carried over for the subsequent nine tax years until exhausted.

IMPLEMENTATION CONSIDERATIONS

This bill would require a taxpayer to commercialize the product in California for five years to qualify for the tax credit, but fails to provide any recapture of the credit if the taxpayer fails to meet this requirement. Lack of a recapture provision could allow a taxpayer to claim the credit without meeting the five year requirement for commercialization. To eliminate disputes between the taxpayer and the department, the author may wish to amend the bill to include a claw back provision for prior credits used if the five year required period is not met.

FISCAL IMPACT

The implementation of this bill would require the department to create a new tax form, establish a new credit code, and make minor system changes. These changes would not have a significant impact on the department's costs. If it is the intent of the bill to add a "patent box" to the form, these costs would increase because additional changes would have to be made to current tax forms as well as to current systems. As the bill continues to move through the legislative process, the additional costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1818 As Amended May 17, 2012 For Taxable Years Beginning On or After January 1, 2012 Assumed Enactment After June 30, 2012 ($ in Millions)		
2012-13	2013-14	2014-15
-$21	-$21	-$23

This estimate is based on the most recent data available to the department at this time. Royalty income is unpredictable. If qualified royalty income were to increase substantially, the revenue impact of this program would increase accordingly.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

SUPPORT/OPPOSITION[1]

Support: TechNet
Central Valley Business Incubator
University of California

Opposition: None on file.

ARGUMENTS

Proponents: Some may argue that this type of tax incentive would increase California's competitiveness not only by spurring firms to invest more in innovation, but also by linking the tax incentive to success at commercializing innovation, which is important for growth, competitiveness, and job creation.

Opponents: Some may argue that patent box type incentives fail to actually address market failure because firms already have all the incentives they need to commercialize innovation in the marketplace.

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[1] As reported on the Legislative Counsel's website at http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_1801-1850/ab_1818_cfa_20120511_121733_asm_comm.html [as of May 22, 2012].

POLICY CONCERNS

This bill allows a credit for royalties paid to any “other entity” besides the University of California. This could lead to the possibility of the following situation. Company A could license the patent from the University and pay royalties for which they could be entitled to a credit. Company A could subsequently sublicense the patent to Company B for royalties. Company B would also be entitled to a credit as long as the patent was owned by the University of California. The author may wish to add language that would limit the credit to the initial acquirer of the license to use the patent from the University of California.

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

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