BILL ANALYSIS

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	**Bocanegra**	**AB 1173**

SUBJECT

Nonqualified Deferred Compensation—Additional Tax on Certain Income /
Exempt Organizations—Simplify Exemption Application Method and Require Active Status /
Motion Picture and Television Production Credit (Movie Credit)—Allow the Credit to Reduce Corporate Tentative Minimum Tax

SUMMARY

This bill has three provisions:

- *Provision 1:* **Nonqualified Deferred Compensation—Additional Tax on Certain Income**

  This provision would reduce California's additional tax on certain nonqualified deferred compensation.

- *Provision 2:* **Exempt Organizations—Simplify Exemption Application Method and Require Active Status**

  This provision would eliminate the requirements for certain federally tax-exempt entities to apply for a California income tax exemption and prohibit a corporation from establishing its California tax exemption until that corporation is listed by the Secretary of State (SOS) and the Franchise Tax Board (FTB) as an "active" corporation.

- *Provision 3:* **Movie Credit—Allow the Credit to Reduce Corporate Tentative Minimum Tax**

  This provision would allow the Movie Credit to reduce a corporate taxpayer's tax below tentative minimum tax, retroactively to 2011.

A separate analysis of each provision begins on page two, and for convenience, a summary table of this bill's estimated revenue impact is provided below:

AB 1173
Summary Revenue Table

	2012-13	2013-14	2014-15	2015-16
Provision 1	$0	- $4,700,000	- $3,200,000	- $3,400,000
Provision 2	$0	$0	- $9,000	- $20,000
Provision 3	- $9,300,000	- $800,000	- $1,300,000	+ $10,000
Totals	**- $9,300,000**	**- $5,500,000**	**- $4,509,000**	**- $3,410,000**

Gail Hall, FTB Contact Person (916) 845-6333 (Office)	Executive Officer Selvi Stanislaus	Date 9/16/13

<u>*Provision 1:*</u> **Nonqualified Deferred Compensation—Additional Tax on Certain Income**

REASON FOR THIS PROVISION

The reason for this provision is to reduce the rate of additional tax that is imposed on certain nonqualified deferred compensation to more closely approximate the difference between California and federal tax rates.

EFFECTIVE/OPERATIVE DATE

This provision would be effective on January 1, 2014, and would be specifically operative for taxable years beginning on or after January 1, 2013.

BACKGROUND

<u>Deferred Compensation Arrangements</u>

In general, a deferred compensation arrangement allows an owner or an employee to set aside a portion of their income to be paid out at a future date. These arrangements are broken down into two basic categories, "qualified" and "nonqualified" deferred compensation arrangements, as described below.

"Qualified" Deferred Compensation Arrangements (Qualified Plans)

Qualified deferred compensation arrangements (also known as "qualified plans") are plans that comply with the Employment Retirement Income Security Act of 1974 (ERISA). ERISA imposes specific rules on qualified plans, including nondiscrimination requirements that prohibit an employer from providing disproportionate benefits to its employees, and limitations on the amount of contributions that can be made to the plan. However, qualified plans also provide certain tax benefits: employers are allowed to deduct contributions when they are made, employees may make tax-deferred contributions, earnings of the plan may be tax deferred until they are actually paid, and distributions are generally eligible to be transferred to another qualified plan, thereby allowing further tax deferral.

Qualified plans include IRC section 401(k) plans (for non-government organizations), IRC section 403(b) plans (for public education employers), IRC section 501(c)(3) plans (for non-profit organizations and ministers), and IRC section 457(b) plans (for state and local government organizations).

"Nonqualified" Deferred Compensation Arrangements (Nonqualified Plans)

Nonqualified deferred compensation arrangements (also known as "nonqualified plans") are not subject to ERISA, and differ from qualified plans in many ways. Employers are allowed to discriminate by only offering plans to its key employees (e.g., senior management and highly-compensated employees), employer contributions are not limited, and employers may not deduct plan contributions until they are paid.

Nonqualified Plan Rules

Prior to 2005, the determination of when amounts deferred under a nonqualified plan were includible in the income of the individual earning the compensation depended on the facts and circumstances of the plan. A variety of tax principles and Internal Revenue Code (IRC) provisions were relevant in making this determination, including the doctrine of constructive receipt, the economic benefit doctrine, the provisions of IRC section 83, relating generally to transfers of property in connection with the performance of services, and provisions relating specifically to nonexempt employee trusts and nonqualified annuities. Other than the general rules discussed below, that continue to apply, the IRC did not provide rules specifically governing nonqualified deferred compensation, and there were no significant reporting requirements.

The time for income inclusion of nonqualified plans generally depends on whether the plan is unfunded or funded. If the plan is unfunded, then the compensation is generally includible in income when it is actually or constructively received. If the plan is funded, then income is includible for the year in which the individual's rights to the compensation are transferable or not subject to a substantial risk of forfeiture.

In general, a nonqualified plan is considered funded if there has been a transfer of property under IRC section 83. Under that section, a transfer of property occurs when a person acquires a beneficial ownership interest in such property. The term "property" is defined very broadly for purposes of IRC section 83. Property includes real and personal property other than money or an unfunded and unsecured promise to pay money in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from claims of the creditors of the transferor; for example, in a trust or escrow account. Accordingly, if, in connection with the performance of services, vested contributions are made to a trust on an individual's behalf and the trust assets may be used solely to provide future payments to the individual, the payment of the contributions to the trust constitutes a transfer of property to the individual that is taxable under IRC section 83. On the other hand, deferred amounts are generally not includible in income if nonqualified deferred compensation is payable from general corporate funds that are subject to the claims of general creditors, as such amounts are treated as unfunded and unsecured promises to pay money or property in the future.

As discussed above, if the plan is unfunded, then the compensation is generally includible in income when it is actually or constructively received. Under IRC section 451, income is constructively received when it is credited to an individual's account, set apart, or otherwise made available so that it may be drawn on at any time. Income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. A requirement to relinquish a valuable right in order to make withdrawals is generally treated as a substantial limitation or restriction.

Rabbi Trusts

A "rabbi trust" is an arrangement that was developed in an effort to provide employees with security for nonqualified deferred compensation, while still allowing deferral of income inclusion. A "rabbi trust" is a trust or other fund established by the employer to hold assets from which nonqualified deferred compensation payments will be made. The trust or fund is generally irrevocable and does not permit the employer to use the assets for purposes other than to provide nonqualified deferred compensation, except that the terms of the trust or fund provide that the assets are subject to the claims of the employer's creditors in the case of insolvency or bankruptcy.

As discussed above, for purposes of IRC section 83, property includes a beneficial interest in assets set aside from the claims of creditors, such as in a trust or fund, but does not include an unfunded and unsecured promise to pay money in the future.

In the case of a rabbi trust, terms providing that the assets are subject to the claims of creditors of the employer in the case of insolvency or bankruptcy have been the basis for the conclusion that the creation of a rabbi trust does not cause the related nonqualified deferred compensation arrangement to be funded for income tax purposes.[1] As a result, no amount is included in income by reason of the rabbi trust; generally income inclusion occurs as payments are made from the trust.

The IRS has issued guidance setting forth model rabbi-trust provisions. Revenue Procedure 92–64 provides a safe harbor for taxpayers who adopt and maintain grantor trusts in connection with unfunded deferred compensation arrangements. The model trust language requires that the trust provide that all assets of the trust are subject to the claims of the general creditors of the company in the event of the company's insolvency or bankruptcy.

Congress Becomes Aware of Abuses of Nonqualified Plans

From the time that the concept of rabbi trusts was developed, nonqualified plans were designed to attempt to both protect the assets from creditors despite the terms of the trust, and allow deferred amounts to be available to individuals, while still purporting to meet the rabbi-trust safe-harbor requirements set forth by the IRS.

By 2004, Congress became aware of the popular use of nonqualified plans by executives to defer current taxation of substantial amounts of income.[2] Executives often used nonqualified plans that allowed deferral of income, but also provided security of future payment and control over amounts deferred. For example, nonqualified plans often contained provisions that allowed participants to receive distributions upon request, subject to forfeiture of a minimal amount (i.e., a "haircut" provision).

Congress also became aware of techniques that were used to attempt to protect the assets from creditors despite the terms of the trust. For example, the trust or fund would be located in a foreign jurisdiction, making it difficult or impossible for creditors to reach the assets.

[1] This conclusion was first provided in a 1980 private ruling issued by the IRS with respect to an arrangement covering a rabbi; hence, the popular name "rabbi trust." Private Letter Ruling 8113107 (December 31, 1980).

[2] JCS-5-05, General Explanation of Tax Legislation Enacted in the 108th Congress, prepared by the Joint Committee on Taxation.

While the general tax principles governing deferred compensation were well established, the determination whether a particular arrangement effectively allowed deferral of income was generally made on a facts-and-circumstances basis. With limited specific guidance with respect to common nonqualified plans, Congress believed that it was appropriate to provide specific rules regarding whether deferral of income inclusion should be permitted.

Moreover, Congress believed that certain arrangements that allowed participants inappropriate levels of control or access to amounts deferred should not result in deferral of income inclusion, and that certain arrangements, such as offshore trusts, which effectively protected assets from creditors, should be treated as funded and should not result in deferral of income inclusion. As a result, Congress enacted specific rules to govern nonqualified plans in the American Jobs Creation Act of 2004, as discussed below under "Federal Law."

ANALYSIS

FEDERAL/STATE LAW

Federal Law

In the American Jobs Creation Act of 2004, Congress enacted IRC section 409A, that generally provides that all amounts deferred under a nonqualified plan for all taxable years are currently includible in income to the extent not subject to a substantial risk of forfeiture and not previously included in income, unless certain requirements are satisfied, including permissible-distribution rules, requirements with respect to elections, and a prohibition on the acceleration of distributions.[3]

- Permissible-distribution rules provide that distributions from a nonqualified plan are allowed only upon separation from service, death, a specified time (or pursuant to a fixed schedule), a change in control of a corporation, an occurrence of an unforeseeable emergency, or if the participant becomes disabled.

- With respect to elections, a nonqualified plan must provide that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer is made no later than the close of the preceding taxable year, or at such other time as provided in Treasury regulations. In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than six months before the end of the service period.

- No acceleration of distributions may be allowed. In general, changes in the form of distribution that accelerate payments are subject to the rule prohibiting acceleration of distributions. However, it is intended that the rule against accelerations is not violated merely because a plan provides a choice between cash and taxable property if the timing and amount of income inclusion is the same regardless of the medium of distribution.

[3] Section 885 of Public Law 108-357, enacted October 22, 2004.

If amounts deferred under a nonqualified plan are not subject to a substantial risk of forfeiture and the requirements of the American Jobs Creation Act of 2004 are not satisfied, in addition to current income inclusion, interest at the underpayment rate plus one percentage point is imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. The amount required to be included in income is also subject to a 20-percent additional tax.

IRC section 409A is generally effective for amounts deferred in taxable years beginning after December 31, 2004.

Amounts deferred are generally required to be reported to the IRS on an annual basis. Such amounts are required to be reported on an individual's W-2 (or federal Form 1099) for the year deferred even if the amounts are not currently includible in income for that taxable year.

State Law

California conforms to Part 1 of Subchapter D of Chapter 1 of the IRC, containing IRC sections 401 to 420, without regard to taxable year to the same extent as applicable for federal income tax purposes,[4] meaning that California automatically conforms to federal law changes within those sections. As a result, when IRC section 409A was added to the IRC in 2004, California automatically conformed to it, including the interest component and the 20-percent additional tax.

THIS PROVISION

This provision would modify the state's conformity to IRC section 409A by reducing the rate of additional tax from 20 percent to 5 percent of any amount deferred under a nonqualified deferred compensation plan that is includible in income because it is not subject to a substantial risk of forfeiture and does not meet the requirements of the American Jobs Creation Act of 2004.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would not significantly impact the department's programs or operations.

OTHER STATES' INFORMATION

The states surveyed for tax treatment of deferred compensation under IRC section 409A include *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

With the exception of *Florida*, a review of these states' laws found that they follow the federal income inclusion rules of IRC section 409A, but do not impose additional tax on such income.

[4] Revenue & Taxation Code section 17501.

Florida does not impose personal income tax; therefore, rules for income inclusion of deferred compensation of individuals are not applicable.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1173 *Provision 1: Nonqualified Deferred Compensation—Additional Tax on Certain Income* For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013		
2013-14	2014-15	2015-16
- $4,700,000	- $3,200,000	- $3,400,000

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

SUPPORT/OPPOSITION[5]

Support: Agricultural Council of California, BenefitRFT, Inc., California Chamber of Commerce, California Employment Law Counsel, California Society of CPAs, California Taxpayers Association, Del Taco LLC, Dreyer, Edmonds & Robbins, Executive Compensation Solutions, Loeb & Loeb, LLP, LTC Performance Strategies, Inc., Mahoney & Associates, Meyer-Chatfield Corp., Mezrah Consulting, Motion Picture Association of America, Inc., Mullin Barens Sanford Financial & Insurance Services, Munger, Tolles & Olson LLP, National Association of Insurance and Finance Advisors, National Association of Insurance and Finance Advisors of California, National Federation of Independent Business, Paul Hastings LLP, Rex Halverson & Associates, LLC, Robin M. Schachter, Akin Gump Strauss Hauer and Feld LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Spidell Publishing, Inc., Summit Alliance Executive Benefits, LLC, Sunkist Growers Inc., The American Council of Life Insurers, The Association for Advanced Life Underwriting, The Association of California Life and Health Insurance Companies, and Windes & McClaughry Accountancy Corporation.

Opposition: None provided.

[5] From the August 31, 2013, Senate Rules Committee analysis of AB 1173, as amended March 21, 2013.

Provision 2: **Exempt Organizations—Simplify Exemption Application Method and Require Active Status**

REASON FOR THIS PROVISION

The reason for this provision is to allow additional types of federally tax-exempt organizations to use the simplified process of applying for state tax-exempt status.

EFFECTIVE/OPERATIVE DATE

This provision would be effective January 1, 2014, and would be operative as of that date.

ANALYSIS

FEDERAL/STATE LAW

Federal Law

In General

Under the Internal Revenue Code (IRC), certain entities are treated as tax-exempt organizations. A tax-exempt organization can be a trust, unincorporated association, or nonprofit corporation. The terms “nonprofit” and “tax-exempt” have different meanings. Nonprofit status is a matter of state law, which governs the organization and creation of the entity. Tax-exempt status is conferred for purposes of exemption from tax. All tax-exempt organizations are nonprofit, but not all nonprofits are tax-exempt.

Types of Tax-Exempt Organizations

There are 28 different paragraphs under IRC section 501(c) under which an organization can qualify for federal tax-exempt status. Some of the more commonly known types of tax-exempt organizations are described below.

IRC Section 501(c)(3) – Charitable Organizations

Organizations recognized as tax exempt under this IRC section include public charities (e.g., the United Way, the Salvation Army, churches, hospitals, schools, and colleges) and private foundations (e.g., the Bill and Melinda Gates Foundation, the Ford Foundation, the California Endowment, and the Rockefeller Foundation).

IRC Section 501(c)(4) – Civic Leagues, Social Welfare Organizations (Including Certain War Veterans’ Organizations), or Local Associations of Employees

The organizations recognized as tax exempt under this IRC section are civic leagues and social welfare organizations. Social welfare organizations generally fall into one of the following categories:

- Organizations that may perform some type of public or community benefit but whose principal feature is lack of private benefit or profit,
- Organizations that would qualify for exemption under IRC section 501(c)(3) but for a defect in their organizing documents or if they were not "action organizations," and
- Nonprofit organizations that traditionally have been labeled in common parlance as social welfare organizations.

IRC Section 501(c)(5) – Labor, Agricultural, or Horticultural Organizations

Labor, agricultural, and horticultural organizations are tax exempt under this IRC section and may not have earnings that inure to the benefit of any member. They must be educational or instructive, with the goal of improving conditions of work, products, and efficiency.

IRC Section 501(c)(6) – Business Leagues, Chambers of Commerce, etc.

Trade associations that meet the requirements of this IRC section are tax exempt as business leagues. This section also extends tax exemption to chambers of commerce, real estate boards, boards of trade, and professional football leagues.

IRC Section 501(c)(7) – Social Clubs

This IRC section exempts social and recreational clubs from tax. Generally, social clubs are membership organizations supported by dues, fees, charges or other funds paid by their members. Typical organizations that may qualify for exemption under this section are:

- College fraternities and sororities,
- Country clubs,
- Amateur hunting, fishing, tennis, swimming and other sport clubs,
- Hobby clubs,
- Ethnic clubs, and
- Yacht clubs.

Although not all tax-exempt organizations are required to submit a tax-exempt application with the IRS to be tax-exempt, they may wish to file to receive a determination letter of IRS recognition of their tax-exempt status in order to obtain certain incidental benefits such as:

- Public recognition of tax-exempt status,
- Exemption from certain state taxes,
- Advance assurance to donors of deductibility of contributions (in certain cases), and
- Nonprofit mailing privileges, etc.

State Law

In General

Most provisions in the California Revenue and Taxation Code (R&TC) involving tax exemptions are patterned after provisions in the IRC. The following table shows the R&TC sections that are similar to the IRC sections listed above:

R&TC Section	Similar IRC Section	Types of Organizations
23701a	501(c)(5)	Labor, Agricultural, Horticultural Organizations
23701e	501(c)(6)	Business Leagues, Chambers of Commerce, etc.
23701f	501(c)(4)	Civic Leagues, Social Welfare Organizations (including Certain War Veterans' Organizations), or Local Associations of Employees
23701g	501(c)(7)	Social Clubs

Obtaining an Exemption from State Tax

Obtaining a state tax exemption is a separate process from obtaining a federal exemption. Currently, in order to obtain an exemption from state tax under one of the above-listed R&TC sections, an organization must submit a completed exemption application form to the FTB, pay a filing fee of $25, and receive a letter issued by the FTB indicating the organization is exempt from tax. The exemption application is required to include the organization's Articles of Incorporation, bylaws, and financial statements showing assets, liabilities, receipts, and disbursements.

Beginning in 2008, organizations that received a federal determination of tax-exempt status under IRC section 501(c)(3) may obtain state tax-exempt status by submitting only a copy of that federal determination to the FTB.[6]

To be exempt from state tax, an organization must be organized and operated for one or more exempt purposes listed in California's Corporation Tax Law (CTL).

THIS PROVISION

This provision would allow organizations that are federally tax-exempt under IRC sections 501(c)(4), 501(c)(5), 501(c)(6), and 501(c)(7), to submit a copy of their IRS tax-exempt determination letter to the FTB to establish their exemption from state income tax (similar to how IRC section 501(c)(3)'s are currently treated). As a result, these organizations would no longer be required to file an exemption application with the FTB or submit a $25 filing fee. Instead, they would receive their state tax exemption automatically by informing the FTB of the IRS tax exemption and submitting a copy of their IRS determination letter.

[6] R&TC section 23701d(c)(1).

These organizations would continue to receive an acknowledgement letter issued by the FTB verifying their exemption from state tax. Any organizations that are not issued a federal determination letter could still file an application to obtain California tax-exempt status.

This provision would specify that the FTB would not be prevented from revoking tax-exempt status if the organization fails to meet certain California provisions governing exempt organizations.

This provision would require the organization to inform the FTB of the suspension or revocation of the federal tax-exempt status and, upon receipt of the IRS notice of suspension or revocation, allow the FTB to suspend or revoke the organization's state tax-exempt status.

This provision would prohibit an organization formed as a California corporation or qualified to do business in California that is listed by the SOS or the FTB as "suspended" or "forfeited" from establishing its exemption from state income taxes and would provide that the organization would not receive an acknowledgement from the FTB of the organization's exemption until that corporation is listed by the SOS and the FTB as an "active" corporation.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 1413 (Assembly Revenue and Taxation Committee, 2013/2014) would provide the same exempt-organization application simplification changes and active business requirement that would be provided by this provision. AB 1413 is currently in the Senate Appropriations Committee.

AB 1677 (Nestande, Chapter 858, Statutes of 2012) increased the general filing-requirement threshold of the California exempt organization annual information return from $25,000 of average annual gross receipts to $50,000 of such receipts.

AB 831 (Silva, 2011/2012) would have exempted a single-member limited liability company from annual tax and annual fee. Also this bill would have prohibited an organization that is listed by the SOS or the FTB as "suspended" or "forfeited" from establishing its California tax-exempt status and would have provided that the organization would not receive an acknowledgement from the FTB of the organization's exemption until that corporation is listed by the SOS and the FTB as an "active" corporation. AB 831 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 404 (Eng, Chapter 504, Statutes of 2009) eliminated the requirements for certain tax-exempt entities that are granted a federal group exemption to apply separately for state tax exemption, and allowed the FTB to permit inspection of certain exemption documents.

AB 897 (Houston, Chapter 238, Statutes of 2007) eliminated the state requirement for filing a separate application process for certain organizations that receive federal tax-exempt recognition. The organization seeking tax exemption must, however, submit to the FTB its IRS determination letter and be an organization described under IRC section 501(c)(3).

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. A review of the laws of these states found that all six require exempt organizations to apply for tax-exempt status.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1173 *Provision 2: Exempt Organizations—Simplify Exemption Application Method and Require Active Status* For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013			
2013-14	2014-15	2015-16	2016-17
$0	- $9,000	- $20,000	- $20,000

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

SUPPORT/OPPOSITION[7]

Support: California Teamsters Public Affairs Council, Directors Guild of America, International Alliance of Theatrical State Employees, International Brotherhood of Teamsters Local 399, Laborers' International Union of North America Local 724, Professional Musicians Local 47, Recording Musicians Association, and SAG-AFTRA.

Opposition: None provided.

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[7] From the June 6, 2013, Senate Governance and Finance Committee analysis of AB 1413, as introduced March 19, 2013.

Provision 3: **Movie Credit—Allow the Credit to Reduce Corporate Tentative Minimum Tax**

REASON FOR THIS PROVISION

The reason for this provision is to allow corporate taxpayers to fully utilize the movie credit by correcting a technical oversight in the legislative language that would be required in order for the credit to reduce the tentative minimum tax.

EFFECTIVE/OPERATIVE DATE

This provision would be effective January 1, 2014, and specifically operative for taxable years beginning on or after or after January 1, 2011.

BACKGROUND

The so-called "regular tax" that individuals and corporations are generally subject to allows specified exclusions, deductions and credits to reduce that "regular-tax" tax liability. A federal alternative minimum tax (AMT) was enacted in 1969 in an attempt to ensure that individuals and corporations that benefit from exclusions, deductions and credits pay at least a minimum amount of tax. California subsequently enacted its own AMT.

The AMT is the excess of the tentative minimum tax over the regular tax. The tentative minimum tax is calculated separately from the regular tax. In general, tentative minimum taxable income is calculated by starting with taxable income for regular tax purposes, and eliminating or reducing certain exclusions, deductions and credits that are allowed in computing the regular tax. An exemption amount is subtracted from tentative minimum taxable income, and the balance is multiplied by the tentative minimum tax rate to compute the tentative minimum tax. California generally conforms to the federal AMT rules, with modifications, such as the allowable exemption amount and the tentative minimum tax rate.

ANALYSIS

FEDERAL/STATE LAW

Federal Law

General business credits allowed for any tax year are limited to the excess of a taxpayer's "net income tax" over the greater of: (1) the tentative minimum tax for the tax year, or (2) 25 percent of the amount of the taxpayer's "net regular tax" that exceeds $25,000. In addition, the empowerment zone employment credit, the New York Liberty Zone business employee credit, "specified credits," and eligible small business credits have various rules for limiting the usage of credits.[8]

[8] IRC section 38(c).

State Law

The general rule is that tax credits imposed under the Personal Income Tax Law (PITL) or the Corporation Tax Law (CTL) may not reduce regular tax below tentative minimum tax, unless specifically provided otherwise.[9] The Movie Credit may not reduce the regular tax below the tentative minimum tax under the PITL or the CTL.

THIS PROVISION

This provision would allow the movie credit to reduce the regular tax below tentative minimum tax under the CTL for taxable years beginning on or after January 1, 2011.

IMPLEMENTATION CONSIDERATIONS

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 1413 (Assembly Revenue and Taxation Committee, 2013/2014) would allow the Movie Credit to offset tentative minimum tax under the CTL for taxable years beginning on or January 1, 2011, similar to this provision. AB 1413 is currently in the Senate Appropriations Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida and *Minnesota* impose corporate AMT, and *Illinois, Massachusetts, Michigan,* and *New York* do not.

FISCAL IMPACT

This provision would not significantly impact the department's costs.

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[9] R&TC sections 17039 and 23036. Appendixes A and B provide lists of the tax credits that reduce regular tax below the tentative minimum tax and those that do not.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1173 *Provision 3: Movie Credit—Allow the Credit to Reduce Corporate Tentative Minimum Tax* For Taxable Years Beginning On or After January 1, 2011 Assumed Enactment After June 30, 2013				
2012-13	2013-14	2014-15	2015-16	2016-17
- $9,300,000	- $800,000	- $1,300,000	+ $10,000	- $600,000

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

SUPPORT/OPPOSITION[10]

Support: California Teamsters Public Affairs Council, Directors Guild of America, International Alliance of Theatrical State Employees, International Brotherhood of Teamsters Local 399, Laborers' International Union of North America Local 724, Professional Musicians Local 47, Recording Musicians Association, and SAG-AFTRA.

Opposition: None provided.

VOTES

Concurrence	09/12/13	Y: 78	N: 0
Senate Floor	09/12/13	Y: 35	N: 0
Assembly Floor	05/29/13	Y: 78	N: 0

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[10] From the June 6, 2013, Senate Governance and Finance Committee analysis of AB 1413, as introduced March 19, 2013.

Appendix A

Tax Credits That Do Not Reduce Regular Tax Below the Tentative Minimum Tax Under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL)

Current Tax Credits:

- California Motion Picture and Television Production
- Child and Dependent Care Expenses (PITL Only)
- Community Development Financial Institutions Investment
- Disabled Access for Eligible Small Businesses
- Donated Agricultural Products Transportation
- Donated Fresh Fruits or Vegetables
- Enhanced Oil Recovery
- Environment Tax
- 2010 First-Time Buyer (PITL Only)
- Local Agency Military Base Recovery Area Hiring & Sales or Use Tax
- Manufacturing Enhancement Area Hiring
- 2010 New Home (PITL Only)
- New Jobs
- Prior-Year Alternative Minimum Tax
- Prison Inmate Labor

Repealed Credits with Carryover or Recapture Provisions:

- Agricultural Products
- Contribution of Computer Software (CTL Only)
- Employee Ridesharing (PITL Only)
- Employer Childcare Contribution
- Employer Childcare Program
- Employer Ridesharing
- Energy Conservation
- Farmworker Housing-Construction
- Joint Strike Fighter Wages
- Joint Strike Fighter Property Costs
- Low-Emission Vehicles
- Political Contributions (PITL Only)
- Recycling Equipment
- Residential and Farm Sales (PITL Only)
- Rice Straw
- Ridesharing
- Salmon & Steelhead Trout Habitat Restoration
- Solar Pump
- Solar or Wind Energy System
- Technological Property Contribution (CTL Only)
- Water Conservation (PITL Only)
- Young Infant (PITL Only)

Appendix B

Tax Credits That May Reduce Regular Tax Below the Tentative Minimum Tax Under the Personal Income Tax Law (PITL) and the Corporation Tax Law

Current Tax Credits:

- Child Adoption (PITL Only)
- Dependent Parent (PITL Only)
- Enterprise Zone Hiring and Sales or Use Tax
- Joint Custody Head of Household (PITL Only)
- Low-Income Housing
- Natural Heritage Preservation
- Nonrefundable Renters (PITL Only)
- Other State Tax (PITL Only)
- Research
- Senior Head of Household (PITL Only)
- Targeted Tax Area Hiring and Sales or Use Tax

Repealed Credits with Carryover or Recapture Provisions:

- Commercial Solar Electric System
- Commercial Solar Energy
- Los Angeles Revitalization Zone Hiring and Sales or Use Tax
- Manufacturers Investment
- Orphan Drug
- Solar Energy