

Temporary Credit Rate Increases

This bill would gradually increase the credit percentages for the general research credit and the university “basic research” credit over five years, after which the credit percentages would return to the current-law amounts, as shown in the table below:

Taxable Year	General Research Credit Credit Rates		University “Basic Research” Credit Credit Rates	
	Current Law	<i>Proposed by This Bill</i>	Current Law	<i>Proposed by This Bill</i>
2014	15%	18%	24%	27%
2015	15%	21%	24%	30%
2016	15%	24%	24%	33%
2017	15%	27%	24%	36%
2018	15%	30%	24%	39%
2019	15%	15%	24%	24%

Selling and Purchasing Credits

This bill would require the Treasurer’s Office to develop and administer a program to allow the sale and purchase of research credits.

The FTB would be required to notify the Treasurer’s Office on a quarterly basis of all taxpayers that claim the research credit and the amount of credit claimed.

The Treasurer’s Office would be required to create an Internet Web site through which taxpayers could, by January 1, 2017, sell or purchase research credits. Taxpayers would be allowed to request approval from the Treasurer’s Office to sell or purchase research credits, and after such a request, the Treasurer’s Office would be required to approve a taxpayer before that taxpayer could sell or purchase research credits, as follows:

- *Approval to Sell:* The Treasurer’s Office would be required to approve a taxpayer to sell research credits if that taxpayer has a facility in which research and development occurs in this state, less than \$50 million in earnings before income tax, depreciation, and amortization, unused research credit from a previous taxable year, and a determination from the FTB that the credits to be sold are valid.
- *Approval to Purchase:* The Treasurer’s Office would be required to approve a taxpayer to purchase research credits if that taxpayer has had qualified California research expenses within the past five years and that taxpayer conducts a trade or business in this state.

If a taxpayer is approved to sell or purchase research credits, the Treasurer's Office would be required to create an online account for the taxpayer to log into in order to sell or purchase research credits. Each taxpayer would be allowed to sell or purchase up to \$5 million of research credits per taxable year, and the total amount of credits that could be sold in a calendar year would be limited to \$100 million. The price of a research credit would generally be based on the open-market demand, except that the price of a credit sold could not be less than 75 percent of its face value.

If a taxpayer does not reinvest the money received from the sale of research credits into the taxpayer's trade or business or if the purchased credits reduce the taxpayer's tax liability by more than 50 percent, any remaining unapplied credit that is not reinvested or that exceeds 50 percent of the taxpayer's tax liability would be recaptured, and the taxpayer would be liable for any increase in tax attributable to such a recapture.

The Treasurer's Office would be required to notify the FTB on a quarterly basis of each sale or purchase of a research credit, the identity of the taxpayer that purchased the credit, and the amount of credit sold. The FTB would be required to review this information to ensure that a research credit is not being used multiple times.

This bill would establish in the State Treasury the Research and Development Tax Credit Trade Fund. Until the Treasurer's Office would be fully reimbursed for its costs of developing, creating, and starting the Research and Development Tax Credit Trade Fund, 15 percent of the face value of each credit sold or purchased on the Internet Web site (as established by the Treasurer's Office) would be deposited into the Research and Development Tax Credit Trade Fund for purposes of funding this proposed program. Of that 15 percent, 13 percent would be appropriated to the Treasurer's Office for the administrative and start-up costs of implementing this program, and 2 percent would be appropriated to the FTB for its administrative costs of this program. The remaining 85 percent of the face value of each credit sold or purchased would be allowed to be used as a credit against the acquiring taxpayer's tax liability.

Once the Treasurer's Office would be fully reimbursed for its costs of developing, creating, and starting the program to purchase and sell research credits, five percent of the face value of each credit sold through the Treasurer's Office Internet Web site would be deposited into the Research and Development Tax Credit Trade Fund for the purpose of funding the Research and Development Tax Credit Trade Program. Of that five percent, three percent would be appropriated to the Treasurer's Office for its administrative costs of implementing this program, and two percent would be appropriated to the FTB for its administrative costs of administering this program. The remaining 95 percent of the face value of each credit sold or purchased would be allowed to be used as a credit against the acquiring taxpayer's tax liability.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns regarding the selling and purchasing of research credits and the audit rules. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Requiring an FTB Determination that a Credit is Valid

This bill would require a determination from the FTB that a research credit is valid before it could be sold; thus, any taxpayer seeking to sell an unaudited research credit would be required to request that the FTB conduct an audit to determine the credit's validity. Additionally, the term "valid" is undefined, and the absence of a definition could lead to disagreements over its meaning.

Recapture Requirement

This provision would create a recapture rule to provide that if a taxpayer sells a credit and does not reinvest the money received from the sale of the credit into the taxpayer's trade or business or if the purchased credits reduce the taxpayer's tax liability by more than 50 percent, any remaining unapplied credit would be cancelled and any previously applied credit that was not reinvested or that exceeds 50 percent of the taxpayer's tax liability would be recaptured, and the taxpayer would be liable for any increase in tax attributable to the recapture of any credit previously allowed under proposed Government Code section 12097.

It is unclear what the phrase "reinvest the money from the sale of the credit into the taxpayer's trade or business" would mean. Without a specific definition, credit recapture based on this condition would seldom, if ever, occur.

Disclosure of Tax-Return Information

The bill would require the FTB to notify the Treasurer's Office on a quarterly basis of all taxpayers that claim the research credit and the amount of credit claimed. However, the department is prohibited from disclosing or making known in any manner confidential tax-return information unless an exception is specifically provided.¹ Absent an exception from existing disclosure law, the department would be unable to comply with the requirements to report to the Treasurer's Office.

TECHNICAL CONSIDERATIONS

This bill would refer to the research credit as the "research and development tax credit" in numerous places. For consistency with IRC section 41(a), the reference should instead be the "research credit." Additionally, the author may want to consider similar changes to the proposed names of the "Research and Development Tax Credit Trade Program" and the "Research and Development Tax Credit Trade Fund."

¹ R&TC section 19542.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation considerations have been resolved, but anticipate such costs would be significant, particularly for periods occurring before the department would begin to receive its reimbursement of costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1564 As Amended April 22, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)				
2014-15	2015-16	2016-17	2017-18	2018-19
- \$90	- \$200	- \$260	- \$290	- \$230

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

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