

SUMMARY ANALYSIS OF AMENDED BILL

Author: V. Manuel Perez, et al. Analyst: Diane Deatherage Bill Number: AB 653
 Related Bills: See Prior Analysis Telephone: 845-4783 Amended Dates: May 1, and May 6, 2013
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Research and Development Expense Credit Increase/Postsecondary Educational Institution Contribution Credit

SUMMARY

This bill would do the following:

Provision No. 1: Modify the franchise and income tax research credit (Research Credit).

Provision No. 2: Create a franchise and income tax credit for qualified taxpayers that contribute to a regionally accredited postsecondary educational institution to provide curriculum, consultation services, or research that leads to job opportunities in the private sector (Contribution Credit).

This analysis only addresses those provisions of the bill that impact the department.

The provisions of the bill will be discussed separately.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The May 1, 2013, amendments added several co-authors and added a certification process for the Contribution Credit that resolved an implementation consideration discussed in the department’s previous analysis.

The May 6, 2013, amendments added additional co-authors.

As a result of the amendments, the “This Provision,” “Implementation Considerations,” and “Economic Impact” sections of Contribution Credit Provision of the department’s analysis of the bill as introduced February 21, and amended April 16, 2013, have been revised. For convenience the “Technical Considerations,” “Fiscal Impact,” and “Policy Concerns” of the Contribution Credit Provision and the “This Provision,” “Technical Considerations,” “Fiscal Impact,” and “Economic Impact” sections of the Research Credit Provision have been restated for convenience. The remainder of the department’s analysis of the bill as introduced February 21, and amended April 16, 2013, still applies.

Board Position: _____ S _____ NA <u> X </u> NP _____ SA _____ O _____ NAR _____ N _____ OUA	Acting Asst. Legislative Director Date Gail Hall for Jahna Carlson 6/5/13
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Summary of Suggested Amendments

Amendments 1 and 3 would amend the language to include an end date for the modifications proposed in the Research Credit provision.

Amendments 2 and 4 would remove unnecessary duplicative language contained in the definition of qualified taxpayer.

ECONOMIC IMPACT – SUMMARY REVENUE TABLE

Revenue Estimate

Estimated Revenue Impact of AB 653 As Amended May 6, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 (\$ in Millions)			
	2013-14	2014-15	2015-16
Research Credit Provision	- \$32	- \$150	- \$300
Contribution Credit Provision	- \$85	- \$210	- \$270
Total	- \$117	- \$360	- \$570

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

PROVISION 1: Research Credit

THIS PROVISION

Under the Personal Income Tax Law, this provision would incrementally increase the credit percentage applied to qualified research expenses in excess of the base amount from 15 percent to 30 percent over a five year period beginning with taxable year 2014 and ending with taxable year 2018. Under the Corporate Tax Law (CTL), the credit percentage applied to qualified research expenses in excess of the base amount would be incrementally increased from 15 percent to 40 percent over a five year period beginning with taxable year 2014 and ending with taxable year 2018.

Under the CTL, this provision would also increase the credit percentage applied to basic research payments from the current 24 percent to 40 percent at a rate of 5 percent for three years and one percent in the fourth year over the four taxable years 2014 through 2017. For taxable years beginning on or after January 1, 2018, the credit percentage applied to basic research payments would be reduced from 40 percent to 25 percent.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems.

TECHNICAL CONSIDERATIONS

Paragraph (3) of subdivision (b) of Revenue and Taxation Code sections 17052.12 and 23609 need to be amended to include an end date for the modifications that currently apply to taxable years beginning on or after January 1, 2000. Amendments 1 and 3 are provided to make this correction.

FISCAL IMPACT

This provision would modify the calculation of the research credit and require a new form or worksheet to be developed. As a result, this provision would impact the department's printing, processing, and systems modifications costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of Research Credit Provision of AB 653 As Amended May 6, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 (\$ in Millions)		
2013-14	2014-15	2015-16
- \$32	- \$150	- \$300

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

PROVISION 2: Contribution Credit

THIS PROVISION

This provision would create an income and franchise tax credit equal to 25 percent of the qualified contributions made by a qualified taxpayer during the taxable year.

Qualified contributions would be defined as monetary contributions made by a business entity to a regionally accredited postsecondary educational institution for either:

- curriculum or research leading to job opportunities in the private sector, or
- consultation services associated with the establishment of curriculum or research leading to job opportunities in the private sector.

The business entity and the regionally accredited postsecondary educational institution must agree that there is a substantial potential for the future employment of students as a result of the contribution.

Qualified taxpayer would mean a business entity that makes a qualified contribution to a regionally accredited postsecondary educational institution.

Unused credits could be carried forward for ten years.

The department would be authorized to prescribe rules, guidelines, or procedures as necessary and appropriate to carry out the purposes of this credit, including, but not limited to the following:

- Requiring the regionally accredited postsecondary institution to provide the taxpayer with a tax credit certificate that the taxpayer can use to document the contribution. The certificate shall be on a form prescribed by the Franchise Tax Board (FTB).
- Requiring the regionally accredited postsecondary institution to annually provide a list to the FTB of each taxpayer that made a contribution and was issued a certificate during the tax year. The list shall include the name of the taxpayer, the taxpayer's tax ID number, identification of the type of curriculum or research to be developed, and the amount of money contributed.
- Requiring the regionally accredited postsecondary institution to retain a record of the contribution and use of the funds for 10 years following the first year in which the institution reported the contribution pursuant to subparagraph (B).

Standards, criteria, procedures, determinations, rules, notices, and guidelines adopted by the FTB to implement this provision would be exempt from Administrative Procedure Act¹ requirements.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

This provision uses phrases that are undefined, i.e., "business entity," "curriculum or research leading to job opportunities in the private sector," "substantial potential," "regionally accredited postsecondary educational institution," and "regionally accredited." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

¹ The [Administrative Procedure Act \(APA\)](#) establishes rulemaking procedures and standards for state agencies in California. The requirements set forth in the APA are designed to provide the public with a meaningful opportunity to participate in the adoption of state regulations and to ensure that regulations are clear, necessary and legally valid. The APA is found in the California Government Code, commencing with section 11340.

TECHNICAL CONSIDERATIONS

The definition of qualified taxpayer unnecessarily duplicates language in the definition of a qualified contribution. Amendments 2 and 4 are provided to eliminate the duplication.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of Contribution Credit Provision of AB 653 As Amended May 6, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 (\$ in Millions)		
2013-14	2014-15	2015-16
- \$85	- \$210	- \$270

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

POLICY CONCERNS

This provision would allow a credit for qualified contributions that, in some circumstances, could also be deductible as a business expense or charitable contribution. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

This bill would allow a credit for contributions to postsecondary educational institutions located inside and outside of California. Historically, tax credits have been designed to provide incentives for taxpayers to perform various actions or activities within the state that they may not otherwise undertake. But if the bill were to be amended to restrict this credit to contributions to postsecondary educational institutions located in California, this could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to favor in-state businesses. On August 28, 2012, (*Cutler v. Franchise Tax Board*), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Statute is unconstitutional. Specifically, the Court of Appeal held that the California-heavy requirements of this investment incentive statute facially discriminates against interstate commerce, and therefore violates the federal dormant commerce clause. While no court decision has yet invalidated, as a general matter, state income tax credits that provide an incentive for in-state activity, i.e., property placed in service in the state, employees employed in the state, etc., targeted tax credits that are conditioned on location in California may be subject to constitutional challenge.

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

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 653
AS AMENDED MAY 6, 2013

AMENDMENT 1

On page 12, strikeout line 16, and insert:

and before January 1, 2014, the reference to "20 percent" in Section 41(a)(1) of the Internal

AMENDMENT 2

On page 14, line 40, strikeout "to a postsecondary educational institution"

AMENDMENT 3

On page 16, strikeout line 15, and insert:

and before January 1, 2014, both of the following shall apply:

AMENDMENT 4

On page 20, line 25, strikeout "to a postsecondary educational institution"