ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	V. Manuel Perez, et. al	Analyst:	Diane Deatherage	Bill Number:	AB 653
Related Bills:	See Legislative History	Telephone:	845-4783	Amended Date:	August 5, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Research and Development Expense Credit Increase

SUMMARY

This bill would modify the franchise and income tax research credit (Research Credit).

RECOMMENDATION

No position.

Summary of Amendments

The August 5, 2013, amendments added three co-authors, removed a provision that would have allowed an income or franchise tax credit to a taxpayer for a contribution to a regionally accredited postsecondary educational institution, and added language that resolved a technical consideration discussed in the department’s previous analysis.

This analysis replaces the department's prior analysis of the bill as amended May 1, 2013, and May 6, 2013.

REASON FOR THE BILL

The reason for the bill is to develop a long-term economic plan for the state to partner with the private sector's "Innovation Economy" that includes eliminating roadblocks in state law and regulation, and incentivizing investments in capital expenditures.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2014.

ANALYSIS

FEDERAL LAW

Existing federal law allows taxpayers a research credit that is combined with several other credits to form the general business credit. The research credit is designed to encourage companies to increase their research and development activities.

Board Position:			Executive Officer	Date
_______ S	_______ NA	___X___ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	8/9/13
_______ N	_______ OUA			

The research credit for personal income tax taxpayers is determined as the sum of:

1. 20 percent of the qualified research expenses incurred during the taxable year that exceeds the base amount, as defined, and
2. 20 percent of the amount paid or incurred during the taxable year on research undertaken by an energy research consortium.

In addition to the two components listed above, corporate taxpayers are allowed a credit of 20 percent of expenses paid to fund basic research at universities and certain nonprofit scientific research organizations that exceed the base period amount (basic research payments), as defined.

To qualify for the credit, research expenses must qualify as an expense or be subject to amortization, be conducted in the U.S., and be paid by the taxpayer.

STATE LAW

California conforms to the federal credit with the following modifications:

- The state credit is not combined with other business credits.
- Research must be conducted in California.
- The credit percentage for increasing qualified research in California is 15 percent versus the 20 percent federal credit.
- The credit percentage for basic research payments in California is limited to corporations (other than S Corporations, personal holding companies, and service organizations) and is 24 percent versus the 20 percent federal credit.

THIS BILL

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. For taxable years beginning on or after January 1, 2019, the credit percentage would be reduced to 15 percent.

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 30 percent over a five year period beginning with taxable year 2014 and ending with taxable year 2018. For taxable years beginning on or after January 1, 2019, the credit percentage would be reduced to 15 percent.

Under the CTL, this provision would also incrementally increase the credit percentage applied to basic research payments from the current 24 percent to 39 percent over a five year period beginning with taxable year 2014 and ending with taxable year 2018. For taxable years beginning on or after January 1, 2019, the credit percentage applied to basic research payments would be reduced to 24 percent.

IMPLEMENTATION CONSIDERATIONS

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

LEGISLATIVE HISTORY

AB 2506 (Perez, 2011/2012), would have among other things, similar to this provision, incrementally increased the credit percentage applied to qualified research and basic research expenses and would have required an additional reporting requirement for those taxpayers utilizing the credit. AB 2506 failed to pass out of the Assembly by the constitutional deadline.

AB 1484 (Anderson, 2009/2010) would have increased the credit percentage for qualified research expenses to 20 percent and conformed to the federal alternative incremental credit (AIC) percentages for taxable years beginning on or after January 1, 2010. AB 1484 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 2278 (Anderson, 2009/2010) would have increased the credit percentage for qualified research expenses to 20 percent, conformed to the federal alternative simplified credit, and eliminated the AIC methodology for taxable years beginning on or after January 1, 2010. AB 2278 was held in the Assembly Committee on Revenue and Taxation without further action.

SB 444 (Ashburn, 2009/2010) would have increased the credit percentage for qualified research expenses to 20 percent and conformed to the federal AIC percentages for taxable years beginning on or after January 1, 2009. SB 444 failed to pass out of the Senate Committee on Revenue and Taxation by the constitutional deadline.

PROGRAM BACKGROUND

The department annually releases a report on state tax expenditures. The 2012 State Tax Expenditure Report contains information regarding the usage of the Research Expense Credit for the 2009 taxable year. The relevant section begins on page 47 of the report. The entire report can be viewed by accessing: https://www.ftb.ca.gov/aboutftb/tax_expenditure_report_2009.pdf.

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 allows a corporate income tax credit of up to 10 percent of the qualified research expenses in excess of the base amount for research performed in the state. For taxpayers that have been in existence less than four years, the maximum tax credit is reduced by 25 percent for each taxable year during the immediately preceding four taxable years that the taxpayer, or a predecessor corporation that was a business enterprise, did not exist. The credit taken in any taxable year may not exceed 50 percent of the business enterprise's remaining net income tax liability after all other credits have been applied. Unused credits may be carried forward up to five years. *Florida* lacks a comparable credit for personal income taxpayers because *Florida* has no state personal income tax.

For taxable years ending on or before December 31, 2015, *Illinois* corporate and individual taxpayers may claim an income tax credit for qualified expenditures that are used for increasing research activities in *Illinois*. The credit equals 6½ percent of the qualifying expenditures. Unused credits generated in taxable years ending on or after December 31, 2004, may be carried forward for up to five years.

Massachusetts allows corporate taxpayers to claim an excise tax credit for qualified expenditures that are used for increasing research activities in *Massachusetts*. The credit is 15 percent of the basic research payments and 10 percent of qualified research expenses conducted in *Massachusetts*. Effective for taxable years beginning on or after January 1, 2009, and before January 1, 2018, a certified life sciences company is allowed a refundable credit on expenditures for research activity that takes place both within and outside of *Massachusetts*. Unused credits may be carried forward for up to 15 years.

Effective January 1, 2012, *Michigan* replaced the Michigan Business Tax with a corporate income tax. There is no research credit under the corporate or personal income tax. Taxpayers with unused hybrid technology research and development credits that were certificated under the Michigan Business Tax regime may continue to file Michigan Business Tax returns until the credit is paid or exhausted.

Minnesota allows two refundable corporate franchise tax credits for research and development: a general research credit available to all businesses, and a refundable credit allowed to a qualified business for increasing research activities in a biotechnology and health sciences zone. The general research credit is equal to 10 percent (5 percent for the zone-based research credit) for qualified research expenses up to $2 million. The amount of the credit is reduced to 2.5 percent for expenses exceeding the first $2 million. Unused credits may be carried forward up to 15 years.

New York allows a credit for qualified emerging technology companies. The credit is equal to the sum of 18 percent of the cost of research and development property, 9 percent of the qualified research expenses, and the cost of qualified high-technology training expenditures, limited to $4,000 per employee, per year, subject to a maximum of $250,000 per taxable year. Any excess credit can be refunded or applied as a payment for the following taxable year.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 653 As Amended August 5, 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
- $20	- $95	- $190

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

SUPPORT/OPPOSITION

Support: California Hispanic Chambers of Commerce (sponsor) and BIOCOM.[1]

Opposition: None identified.

ARGUMENTS

Proponents: Supporters could argue that this bill would stimulate job creation by offering an enhanced research credit to businesses that have the ability to employ new workers.

Opponents: Some could argue that with the state's fragile economic recovery, additional tax expenditures should be avoided.

LEGISLATIVE STAFF CONTACT

Diane Deatherage	Mandy Hayes	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Acting Asst. Legislative Director, FTB
(916) 845-4783	(916) 845-5125	(916) 845-5683
diane.deatherage@ftb.ca.gov	mandy.hayes@ftb.ca.gov	jahna.carlson@ftb.ca.gov

[1] Assembly Committee on Jobs, Economic Development and the Economy analysis, dated April 23, 2013.