Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Allen & Calderon	Analyst:	David Scott	Bill Number:	AB 886
Related Bills:	See Legislative History	Telephone:	845-5806	Amended Dates:	March 21 & April 16, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: California Exporters & Importers Credit/Tax Credit Certificates

SUMMARY

This bill would do the following:

- Under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), create income and franchise tax credits for the state's exporters and importers.
- Under the Government Code, modify the functions of the California Transportation Financing Authority.

This analysis only addresses the provisions of this bill that impact the department's programs and operations.

RECOMMENDATION

No position.

Summary of Amendments

The March 21, 2013, amendments removed legislative intent language and replaced it with the provisions discussed in this analysis. The April 16, 2013, amendments added a co-author and made changes to the Government Code, that do not affect the department. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to boost exports and imports through California's ports and airports by providing tax incentives for increasing cargo-moving capacity.

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, 2014, and before January 1, 2019.

Board Position:			Executive Officer	Date
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ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in the production of income or property used in a trade or business. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year. The depreciation deduction is generally allowed over a period approximating the property's economic life rather than deducted in the year purchased or acquired. As an incentive for businesses to invest in property, occasionally an accelerated depreciation deduction is allowed. That is, a deduction is allowed at a faster rate than the decline in the property's economic value would warrant.

Depreciable property includes equipment, machinery, vehicles, and buildings, but excludes land. Significant improvements to property are added to the basis of the property and are depreciated over the property's remaining useful life.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research tax credits or economic development area hiring tax credits). These tax credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

The CTL allows the assignment of certain eligible credits to taxpayers that are members of a combined reporting group. "Assignment" refers to the ability of a taxpayer that is a member of a combined reporting group to elect to transfer certain unused credits to a related corporation, as specified. The election to transfer any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.

THIS BILL

Under the Revenue &Taxation Code (R&TC), this bill would create income and franchise tax credits for exporters, as defined, and importers, as defined, that are awarded a tax credit certificate, or certificates, by the California Transportation Financing Authority (Authority) for demonstrating to the Authority's satisfaction any, or any combination of, the following:

- Increasing the volume of cargo flowing through the state's ports, airports, or both, during the taxable year, as specified. The credit amount certified by the Authority would be calculated as $3.125 per ton of increased cargo flowing through the state's ports and $1,000 for each $10,000 increase in value of cargo flowing the state's airports.
- Increasing the number of qualified full-time employees hired in California during the taxable year, as specified. The credit amount certified by the Authority would be calculated as $3,000 per additional qualified full-time employee.
- Capital expenditures for a cargo facility constructed in California during a taxable year. The credit amount certified by the Authority would be calculated as 2 percent of the cargo facility's total capital costs.

The total credits for a taxable year for a taxpayer would be limited to the lesser of the amount specified in the tax credit certificate or certificates issued to a taxpayer or an aggregate total of $250,000.

This bill would allow unused credits to be carried forward for up to 10 years.

The sections of the R&TC that this bill would add would be repealed by their own terms on December 1, 2019.

Under the Government Code, this bill would do the following:

- Authorize the Authority to award tax credit certificates, as defined, to a person that is an exporter or importer in an amount that would be limited to an aggregate total of $250,000 for a taxable year. An aggregate total of $500 million in tax credit certificates would be authorized to be awarded, as specified, on a pro-rata basis ($100 million per calendar year) over the five calendar years beginning January 1, 2014. Underallocated amounts could be awarded in a future calendar year ending before January 1, 2019.

- Require the Authority to do all of the following:

    - Establish a procedure for applicants to apply for tax credit certificates and a process to award tax credit certificates on a first-come-first-served basis.
    - Provide notification to the taxpayer within 45 days of an award of, or denial of an award of, a tax credit certificate.
    - Determine the information an applicant must provide to be awarded a tax credit certificate.
    - Develop and provide tax credit certificate application forms that include the applicant's taxpayer identification number.

- Designate the Authority as the entity responsible for determining the amount of the credit and specifically exclude the Franchise Tax Board (FTB) from this responsibility.

- Require the Authority to provide to the FTB an electronic copy of each credit certificate awarded within 30 days of a certificate's issue date. The certificate would be required to include the date of issuance, amount of the credit, the type of credit awarded, and the name and taxpayer identification of the exporter or importer awarded the credit.

- Require the Authority to establish and implement audit procedures to verify that tax credit certificates were properly awarded consistent with the terms of this bill, cancel tax credit amounts that were erroneously awarded, and notify the FTB of any cancelled amounts.

- Authorize the Authority to issue rules, guidelines, or procedures necessary or appropriate to implement this bill. This authority would be exempt from the regulatory requirements of the Administrative Procedures Act.

- Authorize the Authority to establish and charge a fee to applicants to cover the costs related to carrying out the responsibilities of this bill.

Tax credit certificates would be ineligible for transfer under the Government Code.

The division of the Government Code this bill would add would be repealed by its own terms as of January 1, 2021.

<u>IMPLEMENTATION CONSIDERATIONS</u>

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

An exporter or importer that met the cargo tonnage and dollar value threshold amounts could avoid the incremental nature of the credit by alternating the flow of their cargo from California's airports to ports every other taxable year. If this is contrary to the author's intent, this bill should be amended.

The language in the R&TC that would limit the aggregate credits to the lesser of the amount of the tax credit certificates or $250,000 duplicates language contained in the Government Code and creates ambiguity as to the entity responsible for administering this limitation. Lack of clarity on the administration of the credit could result in disputes between the Authority, the FTB, and taxpayers. If it is the author's intent that the FTB's responsibility would be limited to confirming that reported tax credits "matched" to a tax credit certificate as to taxpayer, tax credit amount, and taxable year, this bill should be amended. In addition, it is unclear whether the recapture language regarding erroneous awards of credits under the Government Code would apply if this limitation is exceeded.

It is unclear when a recapture of a cancelled credit would be reported and when interest would begin to accrue on an underpayment resulting from a recapture. For example, would the recapture be reported on an amended return for the taxable year the cancelled credit was utilized and would interest accrue from the due date of the originally filed return? Or would the recapture be reported and interest accrual begin the taxable year an award is cancelled?

Although the Authority would be required to provide notification to a taxpayer within 45 days of the award of, or denial of, a tax credit certificate, it is unclear when the Authority would be required to take action on an application once an application has been received. To clarify the certification process and ease administration of this credit, the author may wish to consider amending this bill to specify a deadline for the Authority to take action on an application, e.g., within 45 days of the date an application is received.

To insure efficiency and accuracy of data transfer and use, it is suggested that the electronic copy of the tax credit certificates include the names and taxpayer identification number of an exporter's or importer's partners or shareholders, if any, the taxable year the credit certificate applies to, and be provided in a form and manner prescribed by the department.

Corporations that are members of a combined reporting group are allowed to assign credits to other members of the same reporting group. The CTL sections of this bill are silent on the transferability of these credits. Under the Government Code section of the bill, certificates would be ineligible for transfer to other taxpayers. The absence of this inclusion in the CTL, could lead to disputes with taxpayers and would complicate the administration of this credit. The author may wish to amend the bill to specify, in the CTL sections, that the tax credits and certificates are ineligible for transfer.

The language in the bill states that the aggregate amount of credit available would be capped at two hundred fifty thousand dollars ($250,000) per taxable year for each taxpayer that is an exporter or an importer and is reflected in the tax credit certificate. The bill defines exporter and importer as a California taxpayer that is the shipper or consignee of record, respectively. The FTB would receive a copy of the certificate for purposes of determining that the proper amount of the credit was claimed on a taxpayer's income or franchise tax return. Pass-thru entities (S corporations and partnerships) would distribute proportional shares of the credit to its shareholders or partners. Each shareholder or partner would claim the credit on their individual tax return. It's unclear if the committee would provide a certificate to each owner of a pass-thru entity, subject to a $250,000 per taxable year limit, or if the committee provide tax credit certificates to the pass-thru entity subject to the $250,000 per taxable year at the pass-thru level.

Additionally, it appears that the total amount of the credit claimed by an S corporation and it's shareholders could exceed the total amount of the certificate because the S corporation would be entitled to claim one-third of the credit certificate amount on the S corporation's return and the total of the shareholders pro-rata credits would equal 100 percent of the certificate amount. If this is contrary to the author's intent, this bill should be amended.

TECHNICAL CONSIDERATIONS

On page 13, line 25, the language should include "of" after "Section 64141".

On page 17, line 30, the language is "subdivision (d) of the Government Code". The bill should be amended to "subdivsion (d) of Section 64141 of the Government Code", which is the code section included in the related PITL section on page 13, line 27.

LEGISLATIVE HISTORY

SB 810 (Price, 2013/2014) a similar bill, would provide tax credit certificates to California exporters and importers for any, or any combination of the following: increasing the amount of cargo they move through California ports and airports, increasing their number of employees at the ports, as well as for capital expenditures on facilities at those ports. SB 810 is currently in the Senate Rules Committee.

AB 2656 (Calderon, 2011/2012), a substantially similar bill, would have provided tax credit certificates to California exporters and importers for any, or any combination of the following: increasing the amount of cargo they move through California ports and airports, increasing their number of employees at the ports, as well as for capital expenditures on facilities at those ports. AB 2656 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

If this bill is amended to resolve the implementation considerations addressed in this analysis, the bill would not significantly impact the department's costs. It is assumed that the department's activities to administer this bill would be limited to verifying that the taxpayer claiming the credit is in fact the exporter or importer that was awarded a tax credit certificate by the Authority, and then allowing or denying the credit as applicable.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB886 As Amended April 16, 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
-$25	-$85	-$100

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

LEGAL IMPACT

This bill would restrict the tax credit to taxpayers that increase capacity at facilities at California ports or airports, increase cargo volume at California ports, airports, or increase the number of full time employees at California ports and airport. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler* v. Franchise Tax Board), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Stock statutes were unconstitutional. Specifically, the Court of Appeal held that the statutory scheme's requirement of a large California presence in order to qualify for an investment incentive discriminated against interstate commerce, and therefore violated 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 such as the one proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some could argue that this bill would stimulate job creation by offering an income tax credit to exporters and importers that expand the cargo capacity flowing through California's ports and airports.

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

LEGISLATIVE STAFF CONTACT

David Scott	Mandy Hayes	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Acting Asst. Legislative Director, FTB
(916) 845-5806	(916) 845-5125	(916) 845-5683
david.scott@ftb.ca.gov	mandy.hayes@ftb.ca.gov	jahna.carlson@ftb.ca.gov