Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Price	Analyst:	David Scott	Bill Number:	SB 32
Related Bills:	See Legislative History	Telephone:	845-5806	Amended Date:	March 11, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: California Jobs Act/Business Investment Credit Sold to Taxpayers by Treasurer

SUMMARY

This bill would authorize the Treasurer, under the Corporations Code, to sell, at auction, two hundred million dollars ($200,000,000) of tax credits to raise capital to provide investment in small businesses. The Treasurer shall provide the Franchise Tax Board (FTB) the information necessary for the FTB to administer the use of the credits by taxpayers.

This bill also would make changes to the Corporations Code. This analysis only addresses the changes that impact the department's programs and operations.

RECOMMENDATION

No position.

Summary of Amendments

The March 11, 2013, amendments removed provisions of the bill related to the Education Code, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis only addresses the provisions of this bill that impact the department's programs and operations.

REASON FOR THE BILL

The reason for this bill is to unlock private investment capital, to generate innovation and job growth, and drive long-term growth to help jumpstart the economy.

EFFECTIVE/OPERATIVE DATE

This bill would become effective on January 1, 2014, and operative for taxable years beginning on or after January 1, 2015, and before January 1, 2023.

Board Position:			Executive Officer	Date
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ANALYSIS

FEDERAL/STATE LAW

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.

Under California law, the Corporation Tax Law (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.

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, unless specifically excluded by statute. Individuals are allowed to deduct ordinary and necessary expenses paid or incurred for the production of income and for the management, conservation, or maintenance of property held for the production of income. The expenses must not be a nondeductible personal living expense or exceed specific statutory limits.

Under California Personal Income Tax Laws (PITL), a "taxpayer" would include any individual, fiduciary, estate, trust subject to tax imposed by the PITL, or partnership. A partnership can have partners that are subject to either the PITL or the CTL. Under the CTL, a "taxpayer" means any person or bank subject to the CTL, including an association, corporation, business trust, or organization of any kind. This includes S corporations, a trustee, trustee in bankruptcy, receiver, executor, administrator, or assignee.

THIS BILL

This bill would authorize the Treasurer to sell, at auction, two hundred million dollars ($200,000,000) worth of tax credits to taxpayers. The minimum amount that a taxpayer may purchase is ten million dollars ($10,000,000) and the maximum amount that a taxpayer may purchase is twenty million dollars ($20,000,000). The Treasurer will issue each taxpayer, purchasing tax credits, a written document as evidence of the purchase. The Treasurer would notify the FTB of the names, identification numbers, and the amount of tax credits purchased by taxpayers that will be available to be claimed against the taxpayer's personal income tax or corporate income tax.

For taxable years beginning on or after January 1, 2015 and before January 1, 2023, taxpayers that have purchased the above tax credits may use those credits to offset their income tax liability. The credits may be claimed in the following amounts:

- For taxable years 2015 to 2018, the taxpayer may use 15 percent of the total amount of the credits purchased, as evidenced on the document provided by the Treasurer.
- For taxable years 2019 to 2022, the taxpayer may use 10 percent of the total amount of the credits purchased, as evidenced on the document provided by the Treasurer.

Taxpayers would be required to provide substantiation of the credit to the FTB, or the credit would be disallowed.

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

This bill would remain in effect until December 1, 2023, and would be repealed as of that date.

IMPLEMENTATION CONSIDERATIONS

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.

Because this bill fails to specify otherwise, the corporate credit this bill would create would be eligible for assignment. If this is contrary to the author's intent, this bill should be amended.

Because this bill fails to specify otherwise, a taxpayer could be allowed a deduction for the cost of the credit in the year of purchase in addition to the credit this bill would create. If this is contrary to the author's intent, this bill should be amended.

It is unclear whether a credit carryforward amount would be subject to the percentage limitation applicable for the taxable year or would be allowed in addition to the percentage limitation. For example, if the taxpayer purchases a ten million dollar certificate in the first year available, they would be entitled to claim 15 percent their 2015 return. If the taxpayer's tax liability, before credits, is only one million dollars, then the taxpayer would have a carryover of five hundred thousand dollars. For 2016 taxable year, would the taxpayer be allowed to claim two million dollars of credits ($1.5 million (15 percent of the total) plus the $500 thousand carryover), if they had that much of a tax liability, or would the taxpayer be limited to 15 percent, which is one million five hundred thousand dollars? The author may wish to clarify this issue to avoid disputes between taxpayers and the department.

In general an S corporation and its shareholders are allowed in the aggregate, 133 percent of the value of a credit because the shareholders in total are allowed 100 percent of the value of the credit and the S corporation is allowed 33 percent of the value of the credit. If it is contrary to the author's intent to allow credits that exceed 100 percent of the value of the credit in this situation, this bill should be amended.

TECHNICAL CONSIDERATIONS

The bill language on page 5, lines 32 and 33, would allow the taxpayer to claim the credit against the personal income and corporate income tax. California also has a franchise tax under Part 11 of the Revenue and Taxation Code. It is suggested that the bill be amended to replace "corporate income tax" with "corporate income or franchise tax", in order to include the franchise tax.

LEGISLATIVE HISTORY

SB 1467(DeSaulnier, 2011/2012) a similar bill, would have established two hundred million in tax credits as incentive to raise private capital to invest in California small businesses. SB 1467 did not pass out of the legislature by the constitutional deadline.

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. *Tennessee* was also surveyed because its program is the basis for this bill.

Florida has the Capital Investment Credit that provides a tax credit equal to five percent of the capital invested to qualified projects in *Florida*. The credit may be applied to a taxpayer's corporate income tax liability or premiums tax liability. The qualified project must create specific levels of jobs, depending on the project.

Massachusetts has the Community Investment Tax Credit that provides a tax credit equal to 50 percent of the total qualified investment by a taxpayer. The annual credit usage is capped, has a five year carryover, and can be transferred.

Michigan currently does not have a similar tax credit.

Minnesota has the Small Business Investment Credit that provides a tax credit of 25 percent of the qualified investment by a taxpayer. The credit is available from 2010 to 2015. There is an application process and those approved and also make an investment receive a tax credit certificate. The investment must be in a business headquartered in *Minnesota* and 51 percent of the employees must be located in *Minnesota*.

New York has the Economic Transformation and Facility Redevelopment Investment Credit that provides a tax credit of ten percent of the investment into a qualified closed facility or six percent of the investment into other qualified facilities.

Tennessee provides a tax credit to insurance companies that invest in a qualified TNInvestco. *Tennessee* sells the tax credits to raise capital for the TNInvestco to use as development capital for *Tennessee* businesses. The insurance companies can apply 15 percent of their total credit in each year for taxable years 2012 to 2015, then ten percent of their total credit in each year for taxable years 2016 to 2019. The credit is available only to insurance companies for application against the premiums tax liability.

FISCAL IMPACT

This bill would require some system changes for new credit codes and the calculation for the credit that would require a new form or worksheet to be developed. As a result, this bill would impact the department's printing, processing and storage costs for tax returns. 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 SB 32 As Amended March 11, 2013 For Taxable Years Beginning On or After January 1, 2015 Assumed Enactment After June 30, 2013 ($ in Millions) /1			
2013-15	2015-16	2016-17	2017-18
$0	-$46	-$34	-$31

/1 This estimate assumes that all of the credit purchased by taxpayers will be used to offset franchise tax or income tax. Subsequent to fiscal year 2017-18, credit usage is anticipated to stabilize at approximately $30 million a year until fiscal year 2021-22.

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

SUPPORT/OPPOSITION

Proponents: None provided.

Opponents: None provided.

ARGUMENTS

Proponents: Some could argue that this bill would stimulate job creation by offering an income tax credit to capital investors whose investment is used to provide capital and management assistance to California business entities.

Opponents: Some could argue that the auctioning of credits is a non-cost effective method of getting capital into the hands of California businesses

POLICY CONCERNS

Members of a combined reporting group are allowed to assign credits to other members of the same combined reporting group. The bill language allows a single taxpayer to purchase a minimum of ten million dollars and a maximum of twenty million dollars of credits. If two taxpayers in a single combined reporting group each purchase twenty million dollars of credits and transfer all of the credits to a single member of the group, the total would exceed the twenty million dollar limit. The author may wish to amend the bill to clarify the intent on this issue.

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