



## **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.

### THIS BILL

Under the PITL and CTL, 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 FTB for demonstrating to the FTB'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 FTB 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 FTB 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 FTB 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 bill would define the following terms: annual full-time equivalent, capital costs, cargo facility, export cargo tonnage, export cargo value, exporter, import cargo tonnage, import cargo value, importer, qualified employee, qualified wages, and tax credit certificate.

Additionally the FTB would be required to do the following:

- Award tax credit certificates, as defined, to a taxpayer that is an exporter or importer that demonstrates to the satisfaction of the FTB they have increased imports, exports, or employees. The amount of the credit 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, (\$100 million per calendar year) over the five calendar years beginning January 1, 2014. Under allocated amounts could be awarded in a future calendar year ending before January 1, 2019.
- 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.
- 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.
- Audits shall be conducted at random.

Authorize the FTB to issue rules, guidelines, or procedures necessary or appropriate to implement this bill. These rules, guidelines and procedures would be exempt from the regulatory requirements of the Administrative Procedures Act.

Authorize the FTB 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.

Sections 17053.58 and 17053.59 of the Revenue and Taxation Code would be repealed by their own terms on December 1, 2021. All other sections added by this bill would be repealed by their own terms on December 1, 2019.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns for purposes of a high-level discussion. 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.

Although the FTB 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 FTB would be required to take action on an application once an application has been received. If the FTB is required to complete the application process in 45 days, it would be extremely difficult to complete given that this would be a new workload, outside the current expertise of FTB, requiring the redirection of current resources and possibly the hiring of personal with expertise in transportation and shipping costs. Additionally, the language says the taxpayer must demonstrate to the satisfaction of the FTB that they have increased the freight tonnage or value, incurred costs to expand, or increased the number of employees. This indicates that an audit of the taxpayer's information would occur as part of the application process, which would add time on to the application process. The author may wish to clarify the time frame for processing applications. Additionally, this could result in substantial costs to administer that would translate into significant fees being charged to cover the costs.

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 with the taxable year an award is cancelled?

The new proposed section 17053.59 bars the transfer of tax credit certificates and appears to be in conflict with the provision of the CTL that allows corporations that are members of a combined reporting group to assign credits to other members of the same reporting group. This could lead to disputes between taxpayers and the department and would complicate the administration of this credit. The author may wish to amend the bill to resolve the inconsistency.

The language in the bill states that the aggregate amount of credit available would be capped at two hundred fifty thousand dollars (\$250,000) and reflected in the tax credit certificate. Pass through entities (S corporations and partnerships) would distribute proportional shares of the credit to the shareholders and partners of the entity. Each shareholder or partner would claim the credit on their individual tax return. This would make it difficult for the FTB to match the amount of the tax credits taken on all of the returns relating to a specific tax credit certificate. Additionally, S corporations are entitled to claim one-third of the tax credit certificate's amount on the S-corporation's return and the shareholders are allocated 100 percent of the certificate amount. In this situation, the total amount of the credit claimed would exceed the total amount of the certificate. The author may wish to amend the bill to resolve this issue.

The bill states that the tax certificates will be awarded for five calendar years beginning on January 1, 2014 (year 1) and ending on December 31, 2018 (year 5). The language also states that the taxpayer must show that the increase in cargo tonnage or value, or the net increase in qualified full-time employees, is calculated by comparing the current taxable year to the preceding taxable year, with the first taxable year being on or after January 1, 2014. The language is unclear as to when the tax certificate application would be made. Does the taxpayer need to wait until the end of their 2014 taxable year and compare the 2014 information to their 2013 taxable year, and then file their application? If so, the tax credit certificate would not be issued until sometime during the 2015 calendar year for the increases that occurred during the taxpayer's taxable year 2014. The result would be that no certificates would be issued in 2014.

The bill language lacks a specific due date for applications for tax credit certificates to be submitted. The tax credit certificates are issued on a first-come, first-served basis. Some taxpayer's taxable year may fall such that they would not be able to receive a tax credit certificate. The author may wish to amend the language such that application that are received after the cut-off date (when \$100 million in tax credit certificates are reached for the calendar year) would be considered as being on file for the subsequent year's issuance of tax certificates.

It is unclear how an incomplete application would be handled for purposes of determining first-come, first-served. For example would an incomplete application be placed in a queue pending completion or would the application be rejected in its entirety? To avoid disputes between the department and taxpayers this bill should be amended.

#### TECHNICAL CONSIDERATIONS-

There is inconsistency among the bill's Revenue and Taxation Code Sections' repeal dates. The author may wish to amend the bill to repeal all sections on the same date.

The April 22, 2013 amendments rendered several Government Code section references obsolete. For clarity the obsolete references should be eliminated.

#### **LEGISLATIVE HISTORY**

AB 886 (Allen & Calderon, 2013/2014) a substantially similar bill, would have provided tax credit certificates to California exporters and importers for 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 886 is currently in the Assembly Appropriations Committee.

AB 2656 (Calderon, 2011/2012), a substantially similar bill, would have provided tax credit certificates to California exporters and importers for 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. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

## FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

## ECONOMIC IMPACT

### Revenue Estimate

Estimated Revenue Impact of SB 810 As Amended April 22, 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 credit 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 with the state's current fragile economic recovery, additional tax expenditures should be avoided.

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