ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Knight	Analyst:	Jessica Deitchman	Bill Number:	SB 998
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Dates:	April 9, April 22, and May 6, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: New Aerospace Program Tax Credit

SUMMARY

This bill would provide, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), a credit for capital investments made in a new aerospace project in California.

RECOMMENDATION

No position.

Summary of Amendments

The April 9, 2014, April 22, 2014, and May 6, 2014, amendments, among other things, removed language that would have created a new aerospace hub and a credit based on a difference in "net tax", and replaced it with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis will not address the bill's changes to the Sales and Use Tax Law, as they do not impact the department's programs and operations or state income tax revenue.

REASON FOR THE BILL

The reason for the bill is to bring aerospace manufacturers to the state by providing a tax credit program as an incentive.

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, 2015.

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 credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

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State and Federal law lack a credit comparable to the credit this bill would allow.

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.

THIS BILL

For taxable years beginning on or after January 1, 2015, this bill would, under both the PITL and CTL, provide a tax credit equal to the amount of "capital investment" in a new aerospace project.

"Capital Investment" would mean expenses incurred for site preparation for, and the construction, repair, renovation, improvement, equipping, or furnishing of, a building, structure, or facility or improvement to real property, including associated soft costs. Capital investment includes obtaining and installing furnishing and machinery, apparatus, or equipment for the operation of a business in a building, structure, or facility or improvement to real property, site-related utility and transportation infrastructure improvements, and planting or other environmental components.

The bill would define the following:

- "Manufacturing" means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or, use in the manufacturing of a product to be ultimately sold at retail or to a government customer.
  - Manufacturing includes any improvement to tangible personal property that result in a greater service life or greater functionality that that of the original property.
- "New aerospace project" means the manufacturing, design or testing of aircraft, aircraft engine, guided missiles, space vehicles, propulsion units or related parts or components by the qualified taxpayer, pursuant to a contractual agreement between the qualified taxpayer and a purchaser that commences in this state on or after January 1, 2015, and that has not commenced outside of this state prior to that date.
- "New construction" has the same meaning as that term is defined in Section 70.[1]
- "Primarily" means more than 50 percent.
- "Qualified taxpayer" means a person who is primarily engaged in those lines of business described in code 3364[2] of the North American Industry Classification System (NAICS).

No credit would be allowed after the conclusion or completion of the contractual agreement that is the subject of the new aerospace project.

Any unused credit could be carried over for ten years, or until exhausted.

[1] Of the California Revenue and Taxation Code.
[2] Aircraft Manufacturing, Aircraft Engine and Engine Parts Manufacturing, Other Aircraft Parts and Auxiliary Equipment Manufacturing, Guided missile and Space Vehicle Manufacturing, Guided Missile and Space Vehicle Propulsion Unit and Propulsion Unit Parts Manufacturing, and Other Guided Missile and Space Vehicle Parts and Auxiliary Equipment Manufacturing.

The Franchise Tax Board may prescribe rules, guidelines or procedures necessary or appropriate to carry out the purposes of this section.

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 bill uses terms that are undefined, i.e., "soft costs," "design or testing," "commencing in this state." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

LEGISLATIVE HISTORY

Research found no legislation similar to providing a tax credit equal to the amount of "capital investment" in a new aerospace project.

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. With the exception of Florida, no comparable tax credits or deductions were found.

Florida allows a "capital investment tax credit" of up to five percent of the eligible capital costs generated by a qualifying project, for up to 20 years, and is subject to specific caps. The credit is available to those companies that operate within designated high impact portions of either:

- Clean Energy,
- Corporate Headquarters Financial Services,
- Information Technology,
- Life Sciences,
- Semiconductors, or
- Transportation Equipment Manufacturing.

The business must also:

- Create at least 100 new jobs in Florida in connection with the project; and
- Make a cumulative capital investment of at least $25 million in connection with the project during the period from the beginning of construction to the commencement of operations.

FISCAL IMPACT

The costs to administer this bill have yet to be determined. 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 998 As Amended May 6, 2014 Enactment Assumed After June 30, 2014 ($ in Millions)		
2014-15	2015-16	2016-17
- $16	- $55	- $70

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the bill would encourage large aerospace and manufacturing companies to do business in California and therefore create additional jobs in California.

Opponents: Some may argue that providing a tax credit limited to aerospace or certain manufacturing companies only may be overly narrow and inadvertently exclude industries in California that need assistance.

POLICY CONCERNS

This bill would allow a credit for capital investment costs that are currently capitalized or added to the basis in a property. Additionally the bill fails to preclude the taxpayer from using the same expenses to generate this and another credit. Generally, a credit is allowed in lieu of a deduction or other credit in order to eliminate multiple tax benefits for the same item of expense.

This bill fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis. This bill would provide a 100 percent credit, which would be unprecedented.

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