SCS Agency
Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Campbell	Analyst:	Marion Mann DeJong	Bill Number:	AB 1976
Related Bills:	See Legislative History	Telephone:	(916) 845-6979	Introduced Date:	02/17/98
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Manufacturers' Investment Credit/Excess Credit Refundable Over 3 Years

SUMMARY

This bill would make any Manufacturers' Investment Credit (MIC) that is in excess of "tax" refundable over the following three years for bank and corporation taxpayers and declare the Legislature's intent to appropriate funds for the refunds.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately and would apply to income years beginning on or after January 1, 1998.

LEGISLATIVE HISTORY

SB 671 (Stats. 1993, Ch. 881); SB 676 (Stats. 1994, Ch. 748); SB 38 (Stats. 1996, Ch 954.); SB 1106 (Stats. 1997, Ch. 604).

SPECIFIC FINDINGS

Existing state law allows qualified taxpayers a credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California. This credit is known as the MIC.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes in the SIC Manual. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code and used primarily:

- for manufacturing, processing, refining, fabricating or recycling of property;
- for research and development;

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Board Position:	Agency Secretary Position:	GOVERNOR'S OFFICE USE
____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR ____X____ PENDING	____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO ____________	Position Approved ____ Position Disapproved ____ Position Noted ____
Department Director G. Alan Hunter 3/23/98	Agency Secretary Date	By: Date:

- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control which meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that are an integral part of manufacturing, refining, processing or fabricating, or research and storage facilities that are part of the process, which are used by qualified persons performing manufacturing activities described in specific codes relating to computer, accounting, and office machines, electronic equipment and accessories, biotech or biopharmaceutical activities, semiconductor equipment manufacturing activities and certain aerospace manufacturing activities.

The MIC explicitly excludes certain types of property from the definition of qualified property, including equipment used in the extraction process, furniture, facilities used for warehousing purposes after completion of the manufacturing process, inventory, equipment used to store finished products that have completed the manufacturing process, and tangible personal property used in administration, general management, or marketing.

The MIC provides a variety of special rules for costs paid pursuant to a binding contract and leased property. The credit may be carried over until exhausted, for a maximum of eight years. For small businesses, this carryover period is extended to ten years. The taxpayer must recapture any credit previously allowed if the property is removed from California, disposed of to an unrelated party or converted to an unauthorized use within one year from the date the property is first placed in service in California.

The MIC will become inoperative on January 1, 2001, or on the January 1 of the earliest year after 2001 if the total employment in manufacturing in this state does not exceed by 100,000 jobs the total employment in manufacturing in this state on January 1, 1994. The Employment Development Department (EDD) is required to report to the Legislature annually on this determination.

Certain “new businesses” (as defined) may claim an exemption from sales and use tax instead of this tax credit. The existing sales and use tax law also allows a taxpayer to claim a refund of sales or use tax from the Board of Equalization in lieu of claiming the MIC.

This bill, in the case where the MIC exceeds the “tax,” would allow the excess amount to be credited against other amounts due, and the balance (if any) be refunded to the taxpayer over the following three years on a pro rata basis.

This bill would apply only to Bank and Corporation Tax law (B&CTL) taxpayers.

This bill also would declare the Legislature’s intent to appropriate funds for the refunds.

Policy Considerations

This bill would raise the following policy considerations.

- Critics of the current law MIC argue that the credit is useless since the taxpayer may not have sufficient tax liability within eight years (or ten years) to use the credit before the carryover is lost. This bill would resolve that concern by refunding the credit when there is not sufficient tax liability to use it.

- Historically, refundable credits (such as the state renter's credit, the federal Earned Income Tax Credit and the federal farm gas credit) have had significant problems with fraud.

- This bill would not provide a refundable MIC for Personal Income Tax law (PITL) taxpayers, creating inconsistent application of the MIC between PITL and B&CTL taxpayers. In addition, in the case of B&CTL taxpayers that are partners in partnerships, it is arguable that any MIC that is passed through from the partnership would not be eligible for the refundable treatment so that there is a potential disparity in treatment even among B&CTL taxpayers. However, since the carryforward period is determined at the entity level, it may be arguable that refundability is also determined at the entity level.

Implementation Considerations

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

- The department has not administered a refundable tax credit under the Personal Income Tax law since the renter's credit was suspended in 1993. The department has never administered a refundable tax credit under the B&CTL. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems.

- It is expected that the department would manually review the claims for refunds and attached documentation since the credit refund amounts could be significant.

- It is unclear how credits allowed with respect to qualified costs paid or incurred in years prior to January 1, 1998, that are required to be carried over under current law would be treated under this bill. For example, would any prior year carryover amounts be refunded over the following three years (and which years would they be refunded, 1998-00 or 1999-01), or would they be lost (since the bill deletes the carryover provisions)?

- Since this bill does not provide refundable MIC provisions in the PITL, shareholders of an S corporation would be required to carry forward any MIC that flows through from the S corporation. The same question may arise with respect to corporate partners of partnerships. This could lead to disputes between taxpayers and the department.

- The phrase "shall be credited against other amounts due" is unclear. This phrase could be interpreted in several ways. For example, it could be interpreted to allow the reduction of the current year tax liability, including alternative minimum tax and the $800 minimum franchise tax, to zero, or it could be interpreted to require the payment of a notice of proposed assessment, including one the taxpayer disagrees with and has protested. Additionally, it is not clear if the refund owed to one member of a combined return can be used to pay the amounts due from the remaining members of the combined group. Further, the bill is unclear whether the department could reduce refund amounts in the following three years for amounts due.

- The bill does not specify how refunds are to be made in the three years after the credit is repealed.

- This bill does not modify the hierarchy of B&CTL tax credits (Section 23036), thus the order in which the credits would be applied before the MIC would be refunded is unclear. The hierarchy under PITL includes refundable credits (Section 17039).

- It is unclear whether interest would be paid on the credit amount from the time the return is filed claiming the credit until the refund is issued (which could be up to three years later since the refund must be claimed over three years).

- It is unclear how the refund would be affected by the dissolution or cancellation of the entity claiming the refund.

FISCAL IMPACT

Departmental Costs

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved.

Tax Revenue Estimate

The bill as written is not clear how unused carryovers of credits generated in years prior to January 1, 1998, would be treated. For this estimate, it is assumed that the bill would be interpreted to allow carryover from prior years to be refunded over the years 1998 through 2000. The following table shows the revenue impact under this interpretation.

The estimated revenue impact of this bill is shown in the following table:

Revenue Impact of AB 1976 Effective for Tax Years Beginning on and After January 1, 1998 $ Millions		
1998-99	1999-00	2000-01
($1,300)	($840)	($380)

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Tax Revenue Discussion

The revenue impact of this bill would be determined by the extent that credits exceed the liability remaining after unused credits carryovers from prior years are applied against liability for tax years beginning on and after January 1, 1998.

This estimate was calculated from tax returns for the 1995 and 1996 tax years and U.S. Department of Commerce data for manufacturers' investment in plant and equipment projected to be placed in service in California. This estimate assumes that current year credits may be applied only against regular tax.

Note that this bill would apply to corporations only. Data from 1995 and 1996 returns indicate that corporations account for 89% of credits claimed.

BOARD POSITION

Pending.