

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

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Related Bills: See Legislative History Telephone: 845-3410 Amended Date: 04/12/1999

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Research Expenses Credit May be Transferred

## SUMMARY OF BILL

Under the Bank and Corporation Tax Law (B&CTL), this bill would allow a taxpayer that claims the research expenses credit, to transfer the credit to another taxpayer that has a tax liability under the B&CTL. The bill also would make certain non-substantive technical changes to the research expenses credit.

Under uncodified law, this bill would require the department to develop a system for registering tax credits for the purposes of transfer among taxpayers.

## SUMMARY OF ANALYSIS

The April 12, 1999, amendments removed the provisions that would have made a technical change to the B&CTL definition of "Counsel for the Franchise Tax Board" and added the provisions discussed in this analysis regarding transfer of the research expenses credit.

## EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to income years beginning on or after January 1, 1999.

## LEGISLATIVE HISTORY

AB 1315 (1999) would allow the transfer of the manufacturers' investment credit between affiliated corporations that file a single combined report. AB 482 (1999) would allow taxpayers to assign to affiliated corporations the California seed capital and early stage corporation fund credit.

## SPECIFIC FINDINGS

**Existing state and federal laws** provide various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., child and dependent care credits) or to influence behavior, including business practices and decisions (e.g., research credits).

**Under existing state and federal laws**, generally tax credits may be claimed only by the taxpayer that incurred the credit-related expense. In the case of the low-income housing credit, if a property is acquired during the credit period, the credit may be transferred to the acquiring taxpayer. In addition, for state purposes, a specific statutory authorization permits the low-income housing credit to be transferred between wholly-owned affiliated corporations.

Board Position:

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Department Director

Date

**Gerald Goldberg**

**5/17/1999**

**This bill** would allow a corporate taxpayer that earned the research expenses credit to transfer the credit to another taxpayer that has a tax liability under the B&CTL. Only credits that have been registered with the department for transfer could be transferred. Once a credit is transferred, this bill would allow the transferee taxpayer to carry over to future years any amount of credit that exceeds its tax liability.

**This bill** would require the department to develop a system for registering tax credits for the purposes of transfer among taxpayers. The system must permit verification of a transferred credit that is claimed on a tax return and permit the department to determine whether the transferee taxpayer properly applied the transferred credit.

**This bill** also would make nonsubstantive code maintenance technical changes to the research expenses credit.

### Policy Considerations

This bill would raise the following policy considerations.

1. Generally, tax credits are allowed to the taxpayer that incurred the related expense. Under state law, only the low-income housing credit contains a provision to allow the credit to be assigned, which allows transfer of the credit to the purchaser of the property or between affiliated corporations as long as the affiliation is 100% ownership. Conversely, this bill would allow the credit to be transferred on an unrestricted basis since the bill and does not restrict the class of eligible transferees, which would create a precedent by allowing the credit to be transferred from the taxpayer who incurred the research expenses to any other taxpayer, regardless of corporate affiliation or credit related expenditure. Thus, this bill would allow a credit to taxpayers that did not incur the expense on which the credit is based, thus providing a benefit to one taxpayer for the action of another taxpayer.

Further, it would create a system of "tax benefit transfers" similar to the old federal safe harbor leasing regime. However, tax credits transferable under federal safe harbor leasing rules were limited to tax credits for the purchase of certain property and the transfer was accomplished by a sale-lease back of that property. The research expenses tax credit is based on various expenses such as wages, supplies, rental charges, etc. In the absence of clarification, disputes may arise between taxpayers and the department as to the proper tax treatment of consideration paid in connection with the transfer of a credit under this bill.

2. This bill would provide a tax benefit for taxpayers filing under the B&CTL that would not be provided to other similarly situated taxpayers that file under the Personal Income Tax Law. Thus, this bill would provide differing treatment based solely on entity classification.

### Implementation Considerations

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

1. This bill does not specify any criteria for the department to use in determining whether a credit should be registered for transfer, nor does it specify the manner in which the credit registration scheme is to be implemented (duly-adopted regulation, forms and instructions, or otherwise). In addition, the bill is silent as to the scope of the department's authority for developing criteria, and what would be the standard of judicial review of such departmentally developed criteria. If regulations are the desired implementation vehicle, it would greatly assist the department to have a broad legislative grant to develop any and all criteria for credit transfer under the bill in the absence of statutory criteria.

In addition, this bill is silent with regards to whether a corporation that wishes to transfer its credit would be allowed to charge a fee to the transferee taxpayer, thereby effectively selling its credit. Because of the bill's lack of criteria and silence regarding the department's scope of authority, the bill leaves unclear whether the department should register those credits that taxpayers wish to sell.

2. This bill would go into effect upon enactment and apply to income years beginning on and after January 1, 1999, which would require that the department create this new program immediately upon enactment. Further clarification is needed if the program must be implemented for income years beginning January 1, 1999. Moreover, if the department would be required to implement this program by regulation, it would take the department at least six to eight months to draft and adopt implementing regulations under the Administrative Procedures Act.
3. This bill leaves unclear whether the transferee taxpayer can use the transferred credit in the same income year as the transferor earned the credit or whether the transferee only can use the transferred credit in the succeeding income year (and subsequent income years if limited).
4. The bill does not address whether the entire credit only or portions of the credit may be transferred. If portions of the credit may be transferred, the bill does not address whether or how one credit may be divided among multiple transferees.
5. It is unclear what would happen if a taxpayer transfers a credit, then is audited and the credit is partially or completely disallowed. The bill should clarify the department's authority to readjust the tax liability of the transferee and reclaim the credit amount. Moreover, since there may be occasion where the department's audit of the transferor taxpayer's return may occur after normal expiration of the statute of limitations (i.e., under a waiver), it might become necessary for the department to request waiver of the transferee's statute of limitations to prevent the department from being foreclosed from adjusting the transferee's tax liability when the department determines that part or all of the claimed credit should never have been allowed.

Alternatively, if the claimed credit of the transferor is disallowed only in part, it is unclear how this disallowance would be allocated between the transferor and the transferee, especially if the statute of limitations has expired for one, but not both, of the affected taxpayers.

#### FISCAL IMPACT

##### Departmental Costs

If this bill is amended to resolve the implementation considerations, implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the department's normal annual update.

##### Tax Revenue Estimate

No revenue estimates can be developed at this time.

It is not possible to predict taxpayers' response to the ability to transfer credits. Several issues are unresolved at this time, such as the tax treatment of payments made and received for transfers between related (unitary) and unrelated taxpayers, administrative issues pertaining to registration and verification, etc.

It is projected for income years beginning in 1999 approximately \$450 million in research and development credits will be generated but not applied. These credits could qualify for transfer under this bill.

#### BOARD POSITION

Pending.