Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills: | Telephone: 845-6979 | Introduced Date: 02/18/1999

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Manufacturers' Investment Credit/Delete Repeal Date To Extend Indefinitely

SUMMARY

This bill would remove the repeal date from the Manufacturers' Investment Credit (MIC), extending the credit indefinitely.

EFFECTIVE DATE

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

SPECIFIC FINDINGS

Existing state law allows taxpayers to use various credits against tax such as the MIC. The MIC 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.

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 related to the above activities;
- 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

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computer, accounting, and office machines, electronic equipment and accessories, biotech or biopharmaceutical activities, semiconductor equipment manufacturing activities and certain aerospace manufacturing activities.

For taxpayers engaged in computer programming and computer software related activities, qualified property includes (1) computers and computer peripheral equipment used in those businesses primarily for the development and manufacture of prepackaged software or custom software prepared to the special order of the purchaser who uses the program to produce and sell or license copies of the program as prepackaged software, and (2) the value of any capitalized labor costs directly allocable to the construction or modification of such property.

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 for the sales or use tax that was paid on the purchase of qualified property rather than claiming the MIC.

This bill would remove the repeal date and the manufacturing employment evaluation from the MIC, extending the credit indefinitely.

Implementation Considerations

Implementation of the provision of this bill would occur during the department’s normal annual system update.

Technical Considerations

This bill would delete subdivision (i) and renumber subdivisions (j) and (k). Subdivisions (j) and (k) provide operative dates for changes made to the MIC since its original enactment. Since these subdivisions contain the phrase “the amendments made by the act adding this subdivision shall be operative” and this bill would renumber the subdivisions, taxpayers may have difficulty determining when the previous changes became operative.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

This bill would not affect Personal Income Tax or Bank and Corporation Tax revenues.

Tax Revenue Discussion

The current law MIC will sunset only if employment in manufacturing, not including aerospace, on January 1, 2001, “does not exceed by 100,000 jobs the total manufacturing sector employment in this state on January 1, 1994.” Employment in manufacturing increased by 136,000 between 1994 and 1997. It seems safe to conclude that the targeted increase will be met and that the current law MIC will remain operative indefinitely beyond 2001.

If, however, manufacturing employment were to dip below the 100,000 incremental manufacturing employment target for any year from 2001 on, the MIC would be repealed. The repeal of the MIC would eliminate credits created during the year. However, substantial amounts of unused carryover MIC would remain and could be applied in years beyond the repeal of the MIC.

Generally, the amount of MIC newly created during any given year for the years beyond 2001 is estimated to be in the range of $700 million to $1 billion. The amount of unused carryover credit that could be available is estimated to be over $2 billion. If the MIC were repealed in a year when the newly created credit would have amounted to, say, $800 million, about $300 million of that would have been applied against tax liability with the remainder added to the unused credit inventory.

Note that by extending the MIC, but not the sales tax exemption for qualified new businesses, this bill would result in some substitution of the MIC for the current law sales tax exemption, which would be repealed in the event the employment target should not be met. It is estimated that about 3% of qualified costs in any given year are associated with qualified new businesses for which the sales tax exemption is claimed. In the $800 million example, this means that without the repeal, sales and use tax revenue would be reduced about $24 million. After the repeal, affected taxpayers could claim MIC of $24 million. However, as these are new companies, it is not likely these taxpayers would report sufficient tax liability to apply a significant amount of the credit. The average MIC usage rate for all manufacturers is estimated to be about one-third.

For new taxpayers, the usage rate would most likely be below the average for all manufacturers. However, it the usage rate were as high as one-third, the substitution of MIC for the sales tax exemption would result in revenue losses under Personal Income Tax and Band and Corporation Tax laws of $8 million.

Note that for manufacturing employment to drop sufficiently to repeal the MIC would require a major change in the economy that would most likely affect the amount of MIC that would be generated or applied.

BOARD POSITION

Pending.