Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Brulte | Analyst: Marion Mann DeJong | Bill Number: SB 1075

Related Bills: | Telephone: 845-6979 | Introduced Date: 02/26/1999

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" creditable against any amounts due and 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, 1999.

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); AB 2798 (Stats. 1998, Ch. 323); AB 1976 (1997/1998); AB 473 (1999/2000); AB 765 (1999/2000); SB 818 (1999/2000).

SPECIFIC FINDINGS

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in a business or investment property. The property must have a limited, useful life of more than one year and includes equipment, machinery, vehicles and buildings but excludes land. Property is assigned to specific classifications related to the number of years of its useful life. The property then may be depreciated over the number of years of its useful life (recovery period).

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business.

Existing state law allows taxpayers to use various credits against tax such as the MIC; however, no state law allows any credit that exceeds tax to be refunded. The **MIC** allows qualified taxpayers a credit equal to 6% of the qualified cost paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

The **MIC** 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.

Board Position:			Department Director	Date
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______ N	______ OUA	X PENDING	**Gerald Goldberg**	**4/6/1999**

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, 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.

- Since only about one third of MICs are utilized in the year generated, critics of the current law argue that the credit is not as effective as it should be, 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. On the other hand, the MIC was enacted instead of a sales tax exemption for all manufacturers because of the lower revenue loss resulting from taxpayers’ inability to completely utilize the credit.

- 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.

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 refundable 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, 1999, which 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 three years following the enactment of this bill, 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. 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 to zero of the current year tax liability, including alternative minimum tax and the $800 minimum franchise tax, or it could be interpreted to require the payment of amounts due from other income years. Further, the bill is unclear whether the department could reduce or offset refund amounts in the following three years for amounts due in those periods.

- 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 dissolution or cancellation of an entity claiming the refund would affect the refund.

- It is unclear if the author intends that the refund provision apply to small businesses since the subdivision permitting a carryover for up to ten years for small businesses is not deleted.

FISCAL IMPACT

Departmental Costs

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

Tax Revenue Estimate

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

Revenue Impact of SB 1075 As Introduced February 26, 1999 Effective for Tax Years Beginning on and After January 1, 1999 Enacted after June 25, 1999 $ Millions			
	1999-00	2000-01	2001-02
TOTAL *	($710)	($1,200)	($730)
PIT **	($ 85)	($ 150)	($ 90)
B&C ONLY	**($625)**	**($1,050)**	**($640)**
*As requested by the author's staff, this shows the total revenue loss if this bill were expanded to PIT filers as well as corporations. ** This is the additional revenue loss that would result from the inclusion of PIT filers.			

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

This estimate assumes that this bill would refund carryover credits from all prior years. The revenue impact of this bill would be determined by the extent that credits exceed the liability remaining after unused credit carryovers from prior years are applied against liability for tax years beginning on and after January 1, 1999.

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.