**SCS Agency**
Franchise Tax Board

# ANALYSIS OF AMENDED BILL

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| Author: | Knight | Analyst: | Marion Mann DeJong | Bill Number: | SB 85 |
| Related Bills: | See Legislative History | Telephone: | 845-6979 | Amended Date: | 04/15/1999 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Reusable Launch Vehicle & Launch Site Wage Credit

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| ____ | DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________. |
| X | AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided. |
| ____ | AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________. |
| ____ | FURTHER AMENDMENTS NECESSARY. |
| ____ | DEPARTMENT POSITION CHANGED TO _______________________. |
| X | REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED December 7, 1998, STILL APPLIES. |
| ____ | OTHER - See comments below. |

## SUMMARY OF BILL

This bill would create a credit equal to 10% of qualified wages paid by a qualified taxpayer to employees for performing services related to the engineering, design and manufacture of a Reusable Launch Vehicle (RLV) or any launch site for a RLV.

## SUMMARY OF AMENDMENT

The April 15, 1999, amendments deleted the provisions of the bill as introduced (related to a wage and property credit for the VentureStar® spacecraft and launch site) and replaced them with the RLV wage credit.

The Program History/Background and current law discussion of Specific Findings in the department's analysis of the bill as introduced December 7, 1998, still apply. The remainder of that analysis is replaced with the following.

## EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment. However, the bill specifies that it would apply to taxable or income years beginning on or after January 1, 2000, and before January 1, 2006.

## LEGISLATIVE HISTORY

AB 2361 (1995/1996) would have provided a credit to aerospace companies for making sales to the federal government. The Senate Revenue and Taxation Committee hearing on this bill was canceled at the request of the author.

AB 390 and AB 1779 (1997/1998) would have provided a wage credit and property credit for taxpayers under initial contract or subcontract to manufacture

| Board Position: | | | Department Director | Date |
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| ____ S | ____ NA | ____ NP | | |
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property for ultimate use in a Joint Strike Fighter (JSF). AB 2797 (Stats. 1998, Ch. 322) enacted the JSF credits.

SPECIFIC FINDINGS

**This bill** would create a credit equal to 10% of qualified wages paid or incurred during the taxable or income year by a qualified taxpayer.

“Qualified taxpayer” would be any taxpayer, including any subcontractor, engaged in the engineering, design and manufacture of a RLV or any launch site for a RLV.

“Qualified wages” would mean any wages paid or incurred by a qualified taxpayer to any employee for performing any services related to the engineering, design and manufacture of a RLV or any launch site for a RLV located in California.

Any credit in excess of “net tax” could be carried forward for a total of eight years. Since this bill does not specify otherwise, this credit would not reduce regular tax below tentative minimum tax.

Policy Considerations

This bill would raise the following policy considerations:

- This bill would provide a credit for wages paid or incurred by the taxpayer for any employee for performing any services related to engineering, design or manufacture of a RLV or launch site. Since there is no clear definition for "related to," such wages would arguably include wages paid to administrators, supervisors, professional staff, clerical support or other wages normally included in overhead costs and not "directly allocable" to the RLV or launch site.

- This bill would allow taxpayers located within an enterprise zone to claim the RLV wage credit and an enterprise zone hiring credit based on the same wage amounts. The enterprise zone hiring credit does not restrict the taxpayer to one credit based upon a single employee.

- Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of a wage expense deduction. This bill would have the effect of providing a double benefit for wage expenses. On the other hand, making an adjustment to limit the qualified taxpayer's ordinary wage deduction in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state’s general federal conformity policy.

- This bill would permit a credit for wages paid or incurred with respect to any already binding contract for the engineering, design and manufacture of a RLV and launch site entered into before this bill was introduced, thereby rewarding previously-made business decisions rather than acting as an incentive to influence prospective taxpayer behavior.

Implementation Considerations

The terms “engineering,” “design” and “manufacture” in the definition of qualified taxpayer are not defined. It is also unclear whether a taxpayer must be involved in all three activities or just one of the three activities to be a qualified taxpayer. Further, the phrase “performing any services related to activities specified in paragraph (1) located in this state” is unclear. It appears that this is intended to mean services related to the engineering, design and manufacture of a RLV or launch site. However, it is unclear whether the employee would be required to perform services in this state. Further, it is unclear how narrowly or broadly the phrase "related to" is intended to be construed, which could potentially dramatically affect the amount of wages qualifying for this credit. Reusable launch vehicle and launch sites are undefined. Undefined terms and unclear phrases can lead to disputes between taxpayers and the department. Department staff is available to assist the author with any necessary amendments.

## FISCAL IMPACT

Departmental Costs

If the bill were amended to resolve the implementation considerations, the department’s costs to administer this bill would not be significant.

Tax Revenue Estimate

Revenue losses for this bill over the initial three-year period are projected to be as follows:

| **Fiscal Year Cash Flow Impact<br>Income/Taxable Years Beginning On or After Jan. 1, 2000<br>$ Millions** | | |
|---|---|---|
| **1999-2000** | **2000-2001** | **2001-2002** |
| **- 3** | **- 15** | **- 15** |

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

State revenue effects depend on the value of wages paid in California as part of the RLV project. This analysis assumes that credits can be claimed in the year in which the federal government disburses money under the RLV program. The estimate assumes that the credit is in addition to any other credits/deductions currently allowed for such expenditures.

The federal government has budgeted $282.8 million for the X-33 in 1999 (www.venturestar.com). In addition, NASA has already set aside $760 million in out-year placeholder funds for launch system development (NASA appendix of the federal budget). This estimate assumes, therefore, that NASA will spend about $300 million annually on the RLV program. Because the launch site for the RLV is expected to be Edwards Air Force Base, this analysis assumes that approximately 80% of the work on the project will be performed in California. The estimate assumes that 75% of project expenditures will be wages, or $180 million annually. Since the credit is for any wages paid by any contractor or subcontractor for any services related to activities connected with the RLV project, it is assumed that 100% of all wages are qualified wages.

The estimate assumes that, as a result of regular tax liability and AMT limitations, 75% of credits will be used in the year in which they are generated. The numbers in the table reflect credits used.

## BOARD POSITION

Pending.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill as introduced December 7, 1998.