

SUMMARY ANALYSIS OF AMENDED BILL

Author: Atkins & Mullin Analyst: Jane Raboy Bill Number: AB 437
 Related Bills: See Prior Analysis Telephone: 845-5718 Amended Date: May 5, 2015
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	Research Expenses Credit/Reduce Excess Carryover Credit/R&D-Small Business Grant Program
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SUMMARY

This bill would, under the Personal Income Tax (PITL) and Corporation Tax Laws (CTL), establish a Research and Development (R&D) Small Business Grant Program.

This analysis only addresses the provisions of the bill that impact the department's programs and operations.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The May 5, 2015, amendments modified sunset and repeal dates, and resolved all of the technical considerations discussed in the department's analysis of the bill as amended April 13, 2015. In addition, several technical concerns were identified.

As a result of the amendments, the "Effective/Operative Date," "This Bill," and "Technical Considerations," sections have been revised. In addition, the "Support/Opposition" section has been updated. The remainder of the department's analysis of the bill as amended April 13, 2015, still applies. The "Fiscal Impact," "Economic Impact," and "Policy Concern" sections have been restated for convenience.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2016. The tax provisions are operative for each taxable year beginning on or after January 1, 2016, and before January 1, 2021. This bill also specifically provides that on or after January 1, 2016, and before January 1, 2021, a qualified small business may apply for a one-time cash grant of a percentage of the excess credit amount from a taxable year beginning on or after January 1, 2014, as specified.

THIS BILL

R&D-Small Business Grant Program

On or after January 1, 2016, and before January 1, 2021, a qualified small business may apply for a grant as follows:

Beginning January 1, 2016, a qualified small business may apply for and receive a one-time grant in an amount equal to 10 percent of any excess credit amount that is attributable to taxable years beginning on or after January 1, 2014, and before January 1, 2016, available for carryover into

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taxable years beginning on or after January 1, 2016, for research credits allowed under current law¹. In order to receive a grant, the qualified small business, partner, or S corporation shareholder of a qualified small business would be required to:

- Apply for a grant on a timely filed original return filed with the Franchise Tax Board (FTB) using electronic technology in a form and manner prescribed by the FTB for the taxable year beginning on or after January 1, 2015.
- Apply to the FTB for a certificate indicating the amount equal to 10 percent of the excess credit amount attributable to taxable years beginning on or after January 1, 2014, and before January 1, 2016, available carryover into taxable years beginning on or after January 1, 2016, for a credit allowed under current law.

The FTB would be required to supply the qualified small business with a certificate within 90 days of receiving the application.

“Qualified small business” would mean a taxpayer that meets all of the following requirements for the taxable year with respect to the credit for which a grant is authorized:

- The taxpayer would be allowed a research credit.²
- The taxpayer has gross receipts of \$5 million dollars or less for the taxable year. Gross receipts would mean gross receipts reduced by returns and allowances, as defined in Section 41(c)(7) of the Internal Revenue Code, by excluding gross receipts which are effectively connected with the conduct of a trade or business within the United States, the Commonwealth of Puerto Rico, or any possession of the United States.
- The taxpayer is not an affiliated corporation that is properly treated as a member of a combined reporting group, and no grant would be awarded with respect to a credit that may be assigned.
- The taxpayer has been certified by the Governor's Office of Business and Economic Development as an eligible qualified small business.

“Excess credit amount” would mean the amount of credit that exceeds tax, as applicable, for the first taxable year the credit is allowable and may be carried over to reduce tax in the following year.

For taxable years beginning on or after January 1, 2016, and before January 1, 2021, a qualified small business may annually apply for a grant equal to 15 percent of any excess credit amount attributable to the taxable year in which the credit was allowed under current law. In order to receive a grant, the qualified small business would be required to:

- Apply for a grant on a timely filed original return to the FTB using electronic technology in a form and manner prescribed by the FTB for each taxable year beginning on or after January 1, 2016.

¹ R&TC sections 17052.12 and 23609.

² Ibid.

- Apply to the FTB for a certificate indicating the amount equal to 15 percent of the excess credit amount that is attributable to the taxable year in which a credit is allowed under current law, and available for carryover to the following taxable year.

The FTB would be required to supply the qualified small business with a certificate within 90 days of receiving the application.

The FTB would allocate the certified amounts based on the aggregate applicable amount for the calendar year in which the certificate was issued. The aggregate applicable amount that may be certified for the calendar year beginning January 1, 2016, would be \$100 million, not to exceed \$50 million for each taxable year beginning January 1, 2014, and January 1, 2015. The aggregate applicable amount could not exceed \$50 million for each calendar year beginning on or after January 1, 2017, and before, January 1, 2022, regardless of the taxable year to which the grant relates.

The FTB would allocate the certificates to the qualified small business, partners, or S corporation shareholder on a first-come-first-served basis, determined by the date the taxpayer's original return is received by the FTB. If the returns of two or more qualified small businesses returns are received on the same day and the amount of the credit remaining to be allocated is insufficient to be allocated fully to each, the credit remaining would be allocated to those qualified small businesses on a pro rata basis. The date an application or return is received would be determined by the FTB, and the determination whether the application or return has been timely filed may not be reviewed in any administrative or judicial proceeding.

Pass-thru Entities

For purposes of the research credit under PITL, a pass-thru entity would mean a partnership or S corporation, and under CTL, a pass-thru entity would mean a partnership.

For grants with respect to taxable years beginning on or after January 1, 2014 and before January 1, 2016, the FTB would issue the certificate to the qualified small business, partners, or S corporation shareholders. For grants with respect to taxable years on or after January 1, 2016, the FTB would issue the certificate to the partnership or S corporation.

A certificate would not be issued to an S corporation with respect to the CTL research credit allowed.

Recapture

To the extent the amount of the certificate issued by the FTB is based on a request from a qualified small business, partner, or S corporation shareholder, any amount of the credit finally allowed that is less than the amount of the credit that provided the basis for the grant, the amount of the grant attributable to the credit not allowed would be treated as a deficiency, and assessed and collected.

General Provisions

The FTB would be authorized to prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of the grant program, including any guidelines regarding the allocation of the certificates issued. These rules, guidelines, and procedures, would be exempt from the rules for regulations in the Administrative Procedures Act.

The Controller upon receipt of the certificate issued to the qualified small business, partner, or S corporation shareholder, would pay the qualified small business the grant amount indicated on the certificate. The Governor's Office of Business and Economic Development, upon application by a taxpayer, would certify the taxpayer as a qualified small business that meets the following requirements 1) the taxpayer was allowed a research credit, 2) the taxpayer has gross receipts for the taxable year of \$5,000,000 or less and 3) the taxpayer is not an affiliated corporation that is properly treated as a member of a combined reporting group.

For taxable years beginning on or after January 1, 2016, and before January 1, 2025, gross income does not include any grant received by a taxpayer.

The grant program would remain in effect only until January 1, 2022, and as of that date is repealed, unless a later enacted statute is enacted before January 1, 2022, that deletes or extends the date.

R&D Credit

For taxable years beginning on or after January 1, 2016, in the case where the FTB has issued a certificate for a grant, the following rules would apply:

- The excess credit amount that may be carried over by a taxpayer would be reduced by the amount reflected on the certificate.
- Under PITL, in the case of a pass-thru entity, the amount of the credit that may be passed through to a partner or shareholder would be reduced by the amount reflected on the certificate. "Pass-thru entity would mean a partnership or an S corporation.
- Under CTL, in the case of a pass-thru entity, the amount of the credit that may be passed through to a partner, would be reduced by the amount reflected on the certificate. "Pass-thru entity would mean a partnership.

TECHNICAL CONSIDERATIONS

For internal harmony and consistency between the grant allocation, grant payment, tax return reporting, sunset provisions, and other technical considerations, the following changes are recommended:

- On page 5, line 9, the phrase "before January 1, 2025" should read "before January 1, 2023".
- On page 9, line 25, the phrase "before January 1, 2025" should read "before January 1, 2023".

- On page 9, line 39, the phrase "the following year." should read "the following taxable year."
- On page 10, lines 25 to 26, the phrase "before January 1, 2021," should read "before January 1, 2023,".
- On page 11, lines 14 and 15, the phrase "90 days of receiving the application" should read "90 days of receiving the return with the application".
- On page 11, lines 30 and 31, the phrase "90 days of receiving the return" should read "90 days of receiving the return with the application".
- On page 12, line 3, the phrase, "January 1, 2022," should read "before January 1, 2023,".
- On page 13, lines 36 and 37, the phrase, "January 1, 2022," should read "before January 1, 2023,".
- On page 14, line 1, the phrase, "January 1, 2022," should read "before January 1, 2023,".

FISCAL IMPACT

This bill would require the development of an application process for electronic filing and services, grant certification, database development and testing, and a noticing system to allow for a new grant program under the PITL and CTL. As a result, this bill would significantly impact the department's programs and operations. The additional costs will be developed as the bill moves through the legislative process.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 437 As Amended May 5, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$22	- \$27	- \$27

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Using 2012 tax return data, it was determined that companies with \$5 million or less in gross receipts generated approximately \$130 million of R&D credits that were not used to offset tax liabilities. This amount was reduced by approximately 50 percent to account for companies who

do not meet the definition of a qualified small business as defined in this bill. Using the Department of Finance growth rates, this amount was grown³ to calculate a 2014 and 2015 R&D unused credit balance totaling \$160 million that would be available beginning in 2016 for eligible taxpayers to receive a grant. Although specific data is unavailable, it is assumed that the number of taxpayers applying for the R&D grant is expected to double over a 5-year period. The increase in the number of taxpayers that would apply for the R&D grant includes non-filers, startups, disregarded entities, and other pass-thru entities currently conducting R&D activity yet not reporting the credit on their return because the entity has no tax liability. The applicable percentage of the grant as provided in this bill was then applied. For taxable year 2015, it is expected that approximately \$30 million in grant requests will be made. The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the table above.

SUPPORT/OPPOSITION⁴

Support: Baybio, Biocom, California Asian Pacific Chamber of Commerce, California Healthcare Institute, California Metals Coalition, National Federation of Independent Business, and Small Business California.

Opposition: California Tax Reform Association.

POLICY CONCERNS

This bill would establish a cash grant for which federal law has no counterpart, thus increasing nonconformity.

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³ Indexed using Department of Finance forecasts.

⁴ As noted in the Assembly Committee on Revenue and Taxation bill analysis dated April 24, 2015.