

# SUMMARY ANALYSIS OF AMENDED BILL

Author: Mullin, et al. Analyst: Scott McFarlane Bill Number: AB 544  
 Related Bills: See Prior Analysis Telephone: 845-6075 Amended Date: May 11, 2015  
 Attorney: Bruce Langston Sponsor Franchise Tax Board

<b>SUBJECT:</b>	Research Credit Simplification
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## SUMMARY

This bill would simplify the calculation of the California research credit.

## RECOMMENDATION

Support.

On December 4, 2013, the three-member Franchise Tax Board voted 2-0, with the representative from the Department of Finance abstaining, to generally sponsor the language included in this bill, except that the sponsored language did not include a sunset date for the election of the alternative simplified credit (ASC).

## SUMMARY OF AMENDMENTS

The May 11, 2015, amendments would modify the credit rates of the California ASC for the first seven taxable years of conformity to the federal ASC. The California ASC would equal:

- For taxable years beginning on or after January 1, 2016, and before January 1, 2019, 5 percent of California qualified research expenses that exceed 50 percent of the average California qualified research expenses for the three preceding taxable years;
- For taxable years beginning on or after January 1, 2019, and before January 1, 2022, 7.75 percent of California qualified research expenses that exceed 50 percent of the average California qualified research expenses for the three preceding taxable years; and
- For taxable years beginning on or after January 1, 2022, and before January 1, 2023, 10.5 percent of California qualified research expenses that exceed 50 percent of the average California qualified research expenses for the three preceding taxable years.

The May 11, 2015, amendments would also add co-authors and make minor technical changes.

As a result of the amendments, the “This Bill” and “Economic Impact” sections of the department’s analysis of this bill as introduced February 23, 2015, are revised and provided below. The remainder of the department’s analysis of this bill as introduced February 23, 2015, still applies.

Board Position:	Legislative Director	Date
<u> X </u> S <u>                    </u> NA <u>                    </u> NP	Gail Hall	5/18/15
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## THIS BILL

This bill would simplify the California research credit by conforming to the ASC for taxable years beginning on or after January 1, 2016, and before January 1, 2023, and would eliminate the alternative incremental credit (AIC) for taxable years beginning on or after January 1, 2016. The ASC would be modified for California purposes to provide that qualified research would mean research conducted in California, and the credit would equal:

- For taxable years beginning on or after January 1, 2016, and before January 1, 2019, 5 percent of California qualified research expenses that exceed 50 percent of the average California qualified research expenses for the three preceding taxable years.
- For taxable years beginning on or after January 1, 2019, and before January 1, 2022, 7.75 percent of California qualified research expenses that exceed 50 percent of the average California qualified research expenses for the three preceding taxable years.
- For taxable years beginning on or after January 1, 2022, and before January 1, 2023, 10.5 percent of California qualified research expenses that exceed 50 percent of the average California qualified research expenses for the three preceding taxable years.

For taxable years beginning on or after January 1, 2016, and before January 1, 2023, the ASC would equal 4.5 percent of California qualified research expenses if a taxpayer has no California qualified research expenses in any one of the three preceding taxable years.

An election to use the ASC would apply to all succeeding taxable years that begin before January 1, 2023, unless revoked with the consent of the Franchise Tax Board.

This bill would additionally conform to recent federal modifications to special rules that apply for purposes of the research credit when a major portion of a trade or business (or unit thereof) changes hands, and for the aggregation of expenditures among commonly-controlled or otherwise-related entities.

## ECONOMIC IMPACT

### Revenue Estimate

Estimated Revenue Impact of AB 544 As Amended May 11, 2015 Assumed Enactment After June 30, 2015 (\$ in Millions)		
2015-16	2016-17	2017-18
- \$17	- \$60	- \$75

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

## Revenue Discussion

Using tax-return data, a micro-simulation model was used to estimate the revenue impact of eliminating the AIC and allowing the ASC at general rates of 5 percent for taxable years 2016 through 2018, 7.75 percent for taxable years 2019 through 2021, and 10.5 percent for the 2022 taxable year. The simulation assumed that taxpayers that have been electing the AIC would instead elect ASC, and that taxpayers that have been calculating their research credit using the general calculation method would elect the ASC if it increases the amount of their credit. The simulation results in an estimated loss of approximately \$60 million for the 2016 taxable year and increases to \$125 million for the 2022 taxable year.

The estimated \$60 million 2016 taxable-year loss is grown,<sup>1</sup> converted to fiscal years and then rounded to arrive at the estimates shown in the table above.

## LEGISLATIVE STAFF CONTACT

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<sup>1</sup> “Grown” means indexed for projected growth using forecasts from the Department of Finance.