



Analysis of Original Bill

Author: Lackey, et al.

Sponsor:

Bill Number: AB 1878

Analyst: Davi Milam

Phone: (916) 845-2551

Introduced: January 17, 2018

Attorney: Bruce Langston

Related Bills: See Legislative
History

Subject: Exclusion/ Space Transportation Company Income

Summary

This bill would, under the Corporation Tax Law (CTL), allow a space transportation company a gross income exclusion.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to provide tax incentives to ensure that California's space industry continues to thrive and remain the worldwide space industry leader.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment, and retroactively operative for taxable years beginning on or after January 1, 2017.

Program Background

In recent years, private industry has begun transporting property, and ultimately, persons, into space for profit. Space transportation industry experts contacted the FTB over uncertainty on how to determine what portion of a taxpayer's net income is subject to the tax already imposed by the California R&TC. In cases where goods or property are transported into space, it was unclear where the benefit of such services was located. Similar to other transportation industries operating in California, the standard allocation and apportionment provisions have proven difficult to apply to this emerging business model. Consequently, the FTB, working with industry, promulgated a regulation that provides a special industry apportionment formula similar to other transportation industry regulations (trucking, railroads, and air) so that the apportionment of income of space transportation companies fairly reflects the activities of such businesses in this state.

Under California Code of Regulations section 25137-15, *Apportionment and Allocation of Space Transportation Companies*, a space transportation company, as defined, uses a special apportionment formula that derives the sales factor using a weighted-mileage factor and a weighted-departure factor, rather than the standard apportionment formula. The regulation, supported by industry at the formal public hearing on June 16, 2017, provides clarity in connection with determining the amount of business income subject to tax by this state.

The regulation, effective September 28, 2017, is applicable to taxable years beginning on or after January 1, 2016. Additional information, including an example, may be accessed on the department's website.¹

Federal/State Law

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Under current state law every business actively engaging in transactions or activity in this state for the purpose of pecuniary gain or profit is subject to tax for the privilege of doing business in this state.² Businesses that engage in business activity within and without this state must apportion their incomes. The amount to be apportioned to California is determined by a formula. In general, the formula measures relative levels of business activity in the state using a single-sales factor. Beginning in 2013, most taxpayers use an apportionment formula based on sales, which is referred to as market-based apportionment. Generally, the standard apportionment rules now require the location of a service for apportionment purposes to be determined according to where the location of the benefit of service is received.

Current state law permits the Franchise Tax Board (FTB) to allow or impose an alternative formula when the standard allocation and apportionment formulas do not fairly reflect the business activity of an apportioning taxpayer's activity in this state.³ The FTB is empowered to promulgate special industry regulations to achieve this goal. For example, transportation industries, including air, railroad, and trucking are among those industries using an alternative formula that more fairly reflects their business activity in this state.⁴

¹ FTB Final Regulations are at <https://www.ftb.ca.gov/tax-pros/law/final-regulations/index.html>.

² Revenue and Taxation Code (R&TC) section 23101.

³ R&TC section 25137.

⁴ Title 18, California Code of Regulations (CCR), sections 25137-7, 25137-9, and 25137-11.

For taxable years beginning on or after January 1, 2016, Title 18, California Code of Regulations, section 25137-15 prescribes a special industry apportionment formula for space transportation companies. The special formula uses a sales factor comprised of a weighted-mileage factor and a weighted-departure factor to determine the amount of business income subject to tax by this state.⁵

Neither federal nor state law allows a gross income exclusion similar to the one that would be provided by this bill.

This Bill

For each taxable year beginning on or after January 1, 2017, this bill would allow a space transportation company to exclude from gross income the amount of business income attributable to sources within this state, as determined pursuant to R&TC section 25137, and any associated regulations.

This bill would define the following terms and phrases:

- “Space” means an altitude of 62 statute miles or more above the surface of the earth.
- “Space transportation activity” means the movement or attempted movement of people or property, including without limitation, launch vehicles, satellites, payloads, cargo, refuse, or any other property to space.
- “Space transportation company” means a taxpayer that generates more than 50 percent of its gross receipts from the provision of space transportation activities for compensation in a taxable year.

Implementation Considerations

The department has identified the following implementation concerns for purposes of a high-level discussion. Additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

If this bill were enacted in the 2018 legislative session, the exclusion allowed by this bill would be considered retroactive to the specified operative date of January 1, 2017, and exclusions claimed by taxpayers could be construed as a gift of public funds. Additionally, the department has already developed the forms and instructions for the 2017 taxable year and taxpayers have begun filing returns for that tax year. Tax preparation software vendors have also developed programs for the 2017 taxable year. To adopt this statutory change for the 2017 taxable year, the department and tax preparation software vendors would incur additional

⁵ Refer to subsection (e) of CCR section 25137-15 for an illustrative example of the application of the special apportionment formula for space transportation companies.

costs to revise tax forms and instructions and reprogram information systems in the short time frame necessary to ensure they are available for taxpayers. To alleviate these concerns, the author may wish to change the operative date to taxable years beginning on or after January 1, 2018.

Under the terms of this bill, the taxpayer must compute the amount of excludable business income attributable to this state by using the allocation and apportionment provisions under R&TC section 25137, including the recently promulgated regulation. Gross income would then be reduced by the calculated business income. Absent clarification, this computation results in a circular loop as each iteration computes the amount of excludable business income that would result in further reduction of gross income.

If the author's intent is to exempt from tax the business income of space transportation companies, as defined, then incorporating the language of the regulation is unnecessary. It is recommended that the bill be amended to clearly express the author's intent.

Legislative History

Research of California legislation found no enacted or proposed legislation similar to the provisions of this bill.

Other States' Information

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide an exclusion comparable to the exclusion allowed by this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida tax law, however, provides incentives for high technology companies, including space flight businesses. Under the corporation tax law, the Department of Economic Opportunity may certify and approve a refund of up to \$6,000 per job created by a spaceflight business pursuant to a tax refund agreement. For taxable years beginning on or after October 1, 2015, and before October 31, 2017, *Florida* tax law also allowed a corporate income tax credit, not to exceed \$1,000,000, for certified space flight companies. Additionally, *Florida* tax law provides a sales tax exemption on property used or occupied predominantly for space flight business purposes and an excise tax exemption for space launch vehicle fuels.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

Economic Impact

Revenue Estimate

Due to the FTB taxpayer confidentiality laws, the FTB is unable to estimate the revenue impact of this bill. However, for every \$10 million in business income attributable to California that is excluded there would be a revenue loss of approximately \$800,000.

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

Support/Opposition

Support: None Provided.

Opposition: None Provided.

Arguments

Proponents: Some may say that this bill would provide necessary tax relief to prevent space transportation companies from relocating outside of California.

Opponents: Some may argue that the tax incentive created by this bill would be inconsistent with the recently promulgated regulation that was sought out and supported by the space transportation industry.

Policy Concerns

This bill would provide a tax benefit for space transportation companies that would be unavailable to other business industries.

This bill would provide a tax benefit for business entities taxable under the CTL that would be unavailable to other business entity classifications.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

Legislative Staff Contact

Davi Milam
Legislative Analyst, FTB
(916) 845-2551
davi.milam@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov