



Analysis of Amended Bill

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Subject: Include Alternative Minimum Tax (AMT) in the Definition of Tax for the Research Credit

Summary

This bill would, under the Corporation Tax Law, modify the definition of tax for purposes of the research credit.

Recommendation – No position.

Summary of Amendments

The March 22, 2018, amendments removed provisions of the bill that would have made a technical change to the property tax law and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for the bill is to add AMT as a tax that may be reduced by the corporate research credit.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for each taxable year beginning on or after January 1, 2019.

Federal/State Law

Research Credit

Existing federal law allows taxpayers a research credit that is combined with several other credits to form the general business credit. The research credit is designed to encourage companies to increase their research and development activities.

To qualify for the credit, research expenses must qualify as an expense or be subject to amortization, be conducted in the U.S., and be paid by the taxpayer. The research is required to be undertaken for discovering information that is technological in nature and its application must be intended for use in developing a new or improved business component of the taxpayer. Substantially all of the activities of the research must be elements of a process of experimentation relating to a new or improved function, performance, reliability, or quality.

Ineligible expenses include seasonal design factors; efficiency surveys; management studies; market research; routine data control; routine quality control testing or inspection; expenses incurred after production; development of any plant, process, machinery, or technique for the commercial production of a business component unless the process is technologically new or improved.

California conforms to the federal credit with the following modifications:

- The state credit is not combined with other business credits.
- Research must be conducted in California.
- The credit percentage for qualified research in California is 15 percent versus the 20 percent federal credit.
- The credit percentage for basic research in California is limited to corporations and is 24 percent versus the 20 percent federal credit.
- The percentages for the alternative incremental research portion of the credit vary from the federal credit.

The research credit cannot reduce the minimum franchise tax or the AMT, and is not refundable. If the available research credit exceeds the current year tax liability, the unused credit can be carried over to succeeding years until exhausted.

AMT

The federal Tax Cuts and Jobs Act (Act)¹ repealed the corporate AMT effective for taxable years beginning after December 31, 2017. California generally conforms to the federal AMT rules in effect prior to the Act, with modifications. Existing state law provides special treatment for some types of income and allows special deductions and credits for some types of expenses. Corporations that benefit from this law may have to pay the AMT in addition to the minimum franchise tax. For general business corporations, the AMT is the excess of the tentative minimum tax (TMT) over the regular tax.

¹An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, enacted on December 22, 2017 as Public Law 115-97.

Corporations that are members of a unitary group filing a combined report must separately compute the AMT for each corporation in the group and the use of the AMT Net Operating Loss (NOL) deduction is restricted in the same manner as the regular NOL.

This Bill

This bill would for each taxable year beginning on or after January 1, 2019, include the AMT in the definition of tax for purposes of the corporate research credit, thus allowing the research credit to reduce the corporate AMT.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Legislative History

SB 81 (Committee on Budget and Fiscal Review, Chapter 22, Statutes of 2015) allowed the College Access Tax Credit to reduce tax below the TMT.

AB 2754 (Committee on Revenue and Taxation, Chapter 478, Statutes of 2014) allowed the GO-Biz California Competes Credit to reduce tax below the TMT.

AB 1839 (Gatto and Bocanegra, Chapter 413, Statutes of 2014) allowed the New Qualified Motion Picture Credit to reduce tax below the TMT.

AB 1173 (Bocanegra, Chapter 536, Statutes of 2013) allowed the Qualified Motion Picture Credit to reduce tax below the TMT.

Other States' Information

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida and Minnesota impose a corporate AMT, which may be reduced by tax credits.

Illinois, Massachusetts, Michigan, and New York laws lack AMT provisions.

Fiscal Impact

This bill would not significantly impact the department's costs.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2574 as Amended March 22, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$26
2019-2020	- \$65
2020-2021	- \$65

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Using Franchise Tax Board (FTB) tax data from the 2016 taxable year, it is estimated that in taxable year 2019 approximately \$220 million of AMT will be reported. Based upon the FTB data for corporations with research credits and AMT, approximately 30 percent of that amount would be expected to be offset by research credits pursuant to this bill. The estimated revenue loss from changing the definition of tax to allow corporations to offset their AMT with research credits would be approximately \$65, million in the 2019 taxable year.

The tax-year estimates are converted to fiscal years and rounded to arrive at the figures in the above table.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some may argue that allowing the corporate research credit to reduce the AMT would provide needed tax relief to corporations.

Opponents: Some may argue that allowing the research credit to reduce the TMT when it exceeds the regular tax is contrary to the purpose of the AMT.

Policy Concerns

Under current state law, corporations are subject to both the regular tax and the AMT if their TMT is greater than their regular tax. Since this bill allows the AMT to be reduced by a tax credit, it is contrary to the purpose of the AMT, which is to assure that no taxpayers with substantial economic income avoid tax liability by claiming exclusions, deductions, and credits (tax preference items).

This bill would provide a tax benefit for corporations that would not be provided to other business entities such as sole proprietorships, noncorporate partners of partnerships, limited partnerships, and limited liability companies not electing to be taxed as corporations, and limited liability partnerships under the Personal Income Tax Law. Thus, this bill would provide differing treatment based solely on classification.

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