STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

Author: Burke	Sponsor:	Bill Number: AB 2758
Analyst: Elaine Segarra Warneke	Phone: (916) 845-7746	Amended: April 18, 2018
Attorney: Bruce Langston	Related Bills: See Prior Analysis	

Subject: Angel Investor Investments in Qualified Small Businesses Credit

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a tax credit to a taxpayer for investing in certain small businesses.

Recommendation – No position.

Summary of Amendments

The April 18, 2018, amendments modified the definition of several terms, removed the provision excluding this credit from the general requirements of Revenue and Taxation Code (R&TC) section 41, and imposed data collection requirements on the Franchise Tax Board (FTB).

As a result of the amendments, several of the department's implementation considerations discussed in the analysis of the bill as introduced on February 16, 2018, have been resolved and three additional implementation considerations have been identified. Except for the "This Bill" and "Implementation Considerations" sections, the analysis of the bill as introduced on February 16, 2018, still applies. The "Fiscal Impact," "Economic Impact," and "Policy Concerns" sections are restated for convenience.

This Bill

For each taxable year beginning on or after January 1, 2020, and before January 1, 2030, this bill would, under the PITL and CTL, allow a tax credit in an amount equal to 5 percent of the amount paid or incurred by an angel investor for investing in a qualified small business for the taxable year in which the FTB issues a credit certificate.

This bill would define the following terms:

- "Angel investor" means an accredited investor that comes within any of the following categories described under applicable Securities and Exchange Commission Regulations, as of January 1, 2018, that is organized as a general partnership, limited partnership (LP), corporation with a valid election to be taxed as an "S" corporation under the Internal Revenue Code (IRC), or a limited liability company (LLC) that has elected to be taxed as a partnership under the IRC. Additionally, the accredited investor must be established and operated for the sole purpose of making investments in other entities, and that seeks returns through private investments in start-up companies and may seek active involvement in the business, including consulting and mentoring the entrepreneur.

- "Qualified small business" means a business that:
  - Has $2,000,000 or less in gross receipts annually averaged over five years, and
  - Is certified under Part 124 (commencing with Section 124.1) of Title 13 of the Code of Federal Regulations related to Business Development/Small Disadvantaged Business Status Determinations.

To receive a credit, the angel investor would be required to:

- Apply to the FTB for a credit reservation, and
- Apply for a credit certificate from the FTB, after the angel investor has invested in a qualified small business.

The FTB would be required to:

- Provide, upon application, a reservation for the credit to an angel investor, if the aggregate amount of the credit allocation amount for the year has not been reached.
- Grant a certificate to an angel investor upon receiving evidence that money has been invested in a qualified small business that meets the definition of qualified small business.
- Collect data related to the amount of the return on investment made from investments in qualified small businesses.

The annual aggregate amount of credits that may be allocated each fiscal year would be $15,000,000.

Credits in excess of the tax liability may be carried over for up to five years.

The credit would be repealed by its own terms as of December 1, 2030.

Implementation Considerations

Department staff have identified the following implementation considerations 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.

It is unclear whether the credit for a taxable year would be 5 percent of the amount paid or incurred during the taxable year, or 5 percent of the amount paid or incurred over the ten-year period from January 1, 2020, to January 1, 2030. For clarity and consistency with the author's intent, this bill should be amended.

The language in this bill appears to allow a CTL credit to reduce the tax due under the PITL for general or LPs or LLCs treated as a partnership, which is inconsistent with existing law. To clarify the author's intent, and ensure consistency within the PITL and CTL provisions of the R&TC, this bill should be amended to limit the CTL credit to those taxpayers subject to the CTL.

It is unclear whether “gross receipts” for purposes of determining eligibility as a qualified small business refers to gross receipts reportable to California or all gross receipts.

The bill lacks administrative details necessary to administer the credit. For example,

- How would requests for credit reservations be processed for purposes of managing the allocation limit? First come first serve?
- What “information and evidence” would an angel investor be required to provide to receive a credit certificate from the FTB?
- Would a request for credit reservation that exceeds the allocation limit be allowed up to the remaining allocation amount or disallowed entirely?
- How would a credit claimed without a credit reservation, certificate, or both, be handled?
- Would an under allocated credit amount from one fiscal year be available for allocation in the subsequent year?
- How would the FTB determine that the definition of angel investor had been met? Would the determination need to be made on an annual basis?
- When and how often would the determination be made as to whether a business was a qualified small business for purposes of this credit? At the time of the initial investment? Initial credit reservation request? Annually during the period of investment?

The aggregate credit amount claimed during a taxable year could differ from the aggregate certified credit amount allocated on a fiscal year basis. Additionally, because the bill fails to specify otherwise, a credit reservation and the subsequent certification could occur in different allocation periods. If this is contrary to the author’s intent, this bill should be amended.

Because the bill fails to specify otherwise, a business in existence for less than five years could fail to meet the definition of qualified small business for the purpose of this credit. If this is contrary to the author’s intent, this bill should be amended.

The credit would be allowed for tax years beginning on or after January 1, 2020, and before January 1, 2030, which is inconsistent with the language what would allow the credit to be based on amounts paid on January 1, 2030, a date in a tax year the credit is no longer available. For internal harmony and consistency with the author’s intent, this bill should be amended.

The bill lacks recapture provisions. Because the bill fails to specify otherwise, an angel investor could withdraw their investment in full or in part upon receiving the credit certificate and would remain eligible for the credit.

The FTB would be required to reserve and certify the credit this bill would allow. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

It is unclear what data related to the amount of the return on investment made from investments in qualified small businesses the FTB would be required to collect. Further, the bill is silent as to whom, when, and how often collected data would be reported.

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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2758 as Amended April 18, 2018
Assumed Enactment after June 30, 2018

($ in Millions)

Fiscal Year	Revenue
2018-2019	$0
2019-2020	- $7.7
2020-2021	- $14.0

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

Research indicates that angel investors invest over $7 billion in California businesses annually. For the credit to be fully allocated $300 million of this $7 billion, or approximately 4 percent, would need to be invested in qualified small businesses. This estimate assumes the credit would be fully allocated and the FTB would make $15 million in credit reservations each year over the life of the credit. Federal regulations require angel investors have annual income greater than $200,000 or net worth greater than $1 million (excluding the value of their personal residence); therefore, taxpayers receiving the credit would be likely to have a tax liability sufficient to offset the credit. It is assumed that 90 percent of the credit would be used in the year generated and the remaining 10 percent would be used in the following five years. This results in a net revenue loss of approximately $14 million in the 2020 taxable year.

The tax-year estimates are split between personal income taxpayers and corporate taxpayers, converted to fiscal-year estimates, and then rounded to arrive at the amounts reflected in the above table.

Policy Concerns

This bill would allow a credit for investments that may be deductible as business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

Legislative Staff Contact

Elaine Segarra Warneke
Legislative Analyst, FTB
(916) 845-7746
elaine.warneke@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