



Bill Analysis

Author: Portantino

Sponsor:

Bill Number: SB 1357

Analyst: Toni Arnold

Phone: (916) 845-4743

Introduced February 21, 2020

Attorney: Shane Hofeling

Related Bills: See Legislative
History

SUBJECT

Election to opt out of certain income tax credits (Research and Development Credit and California Competes Tax Credit) and instead claim a refund of sales tax reimbursement and use taxes paid

SUMMARY

This bill would allow certain taxpayers who meet specified requirements to claim a refund from the California Department of Tax and Fee Administration (CDTFA) for sales tax reimbursement or use tax paid in lieu of claiming a Research and Development (R&D) credit or a California Competes Tax Credit (CCTC) on their California franchise or income tax return.

This analysis is limited to the provisions of the bill that would impact the Franchise Tax Board's (FTB's) programs and operations.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

None noted.

REASON FOR THE BILL

The reason for the bill is to allow taxpayers to forgo use of certain income tax credits and instead claim a refund of sales tax reimbursement or use tax paid.

ANALYSIS

This bill would, under the Sales and Use Tax provisions, on and after January 1, 2021,¹ allow a taxpayer to file a claim for refund of the qualified sales tax reimbursement or use tax (SUT) that the taxpayer has paid, in lieu of the R&D credit or CCTC that would otherwise be allowed to the taxpayer.

¹ Note: this bill uses "on and after;" however, in Technical Considerations below, we suggest a change to "on or after."

The taxpayer would be required to submit the claim for refund to the CDTFA. The taxpayer would be prohibited from requesting a refund of the carryover of the R&D credit or CCTC, until the carryover could be used to reduce the tax liability. The amount of the refund would be limited to the amount that could have been used to reduce the taxpayer's tax liability. The taxpayer would, by filing the claim for refund, make an irrevocable election to waive the equivalent amount of the R&D credit or CCTC for which the refund is made.

The bill would define the following terms and phrases:

- "Qualified person" means a person (including a business entity taxpayer) who has paid qualified sales tax reimbursement or qualified use tax or both.
- "Qualified sales tax reimbursement" means sales tax reimbursement paid to a retailer for the sales tax imposed by various Revenue and Taxation Code (R&TC) sections and the California Constitution.
- "Qualified use tax" means use tax paid to the CDTFA for use taxes imposed by various R&TC sections and the California Constitution.

The claim for refund would be processed by the CDTFA, in a form and manner prescribed by the CDTFA, and the qualified person would be required to submit, among other things, the following documentation with the claim for refund:

- Proof of payment of the sales tax reimbursement or use tax, by the taxpayer, to a California retailer or other seller, such as an invoice or purchase contract, containing the purchase date, description of item purchased, amount paid, and amount of sales tax reimbursement or use tax paid; and
- A copy of the applicable filed California income tax return that includes the taxpayer's tax liability, for which the in-lieu refund is being claimed.

The bill would require that the item purchased for which the refund is claimed be non-exempt under the SUT provisions. Any amount refunded under this bill would exclude interest. Refunds made under the provisions of this bill would be required to be paid from the General Fund, upon appropriation by the Legislature.

The bill would allow the CDTFA to recover an erroneous refund. Except in the case of fraud, the CDTFA would be required to issue a deficiency determination within three years from the last day of the month following the quarterly period in which the refund was approved.

The bill would require the CDTFA to provide an annual listing to the FTB, in an agreed-upon form, of the taxpayers that made a claim for refund and irrevocable election, and the amount of the refund.

Effective/Operative Date

Assuming enactment by September 30, 2020, this bill would become effective and specifically operative on and after January 1, 2021.

Federal/State Law

Federal Law

In federal law, there are no provisions comparable to the SUT or the CCTC.

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 United States, 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. Only expenses for research are included and many expenses are ineligible.

State Law

R&D Credit

California conforms to the federal Research Credit with modifications, including: the research must be conducted in California; the credit percentage is adjusted to 15 percent; and the "alternative incremental calculation" method is allowed.

CCTC

The CCTC, available for taxable years before January 1, 2030, is an income or franchise tax credit available to businesses that come to California or stay and grow in California. CCTC agreements are negotiated by the Governor's Office of Business and Economic Development (GO-Biz) and approved by the CCTC Committee, consisting of the State Treasurer, the Director of the Department of Finance, the Director of GO-Biz (Chair), and one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

Upon approval of the tax credit agreement by the CCTC Committee, GO-Biz informs the FTB of the terms and conditions of the written agreement. The FTB reviews the books and records of taxpayers allocated a CCTC to ensure that the taxpayer complied with the terms and conditions of the written agreement. If the FTB determines that a possible breach of the agreement has occurred, GO-Biz is provided detailed information regarding the basis of the possible breach.

Generally, CCTC cannot be transferred to another taxpayer unless there was a qualifying merger under the Internal Revenue Code or the credit qualifies for assignment to an affiliated corporation.

Credit Assignment

Under California law, the Corporation Tax Law (CTL) allows the assignment of certain eligible credits to taxpayers that are members of a combined reporting group. "Assignment" refers to the ability of a taxpayer that is a member of a combined reporting group to elect to transfer certain unused credits to a related corporation, as specified. The election to transfer any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.

A credit earned by members of a combined reporting group may be assigned to an affiliated corporation that is a member of the same combined reporting group.

Pass-Through Entities

Under California law, partnerships, limited liability corporations (LLCs) not classified as corporations for tax purposes, and S corporations are considered pass-through entities. Partners, members, and shareholders report and are taxed on their pro-rata share of the pass-through entity's income and losses. In addition, partners, members, and shareholders report their pro-rata share of deductions and credits of the pass-through entity as though they received them directly.

Implementation Considerations

Department staff has 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. FTB staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill provides that the CDTFA may recover an erroneous refund within three years from the last day of the month following the quarterly period in which the CDTFA approved the refund. Current state law generally allows the FTB to propose to assess additional tax four years after a tax return is filed or two years after a final federal determination. The protest and appeals process can add additional time before the assessment becomes final. Accordingly, if an FTB audit of the R&D credit or an audit of a credit assignment results in a final assessment of tax, the CDTFA would be unable to recover the applicable refund of the SUT. The author may wish to extend the time the CDTFA may recover an erroneous refund.

Similar to an FTB audit of the R&D credit, the FTB reviews the books and records of taxpayers reporting the CCTC as required by the CCTC agreement. Currently, the CCTC Committee would recapture the credit if the FTB determines upon review that the amount claimed was not earned. Accordingly, if an audit of the CCTC credit results in recapture, the CDTFA may be unable to recover the applicable refund of sales tax reimbursement and use tax. The author may wish to extend the time the CDTFA may recover an erroneous refund.

This bill leaves unclear whether taxpayers that are pass-through entities could claim the refund and make the irrevocable election, or whether the investors (partners, members, or shareholders) could claim the refund of sales reimbursement or use tax (since income tax credits generally flow to investors as discussed in the law section above). For ease of implementation, this bill should state whether the entity and/or the investor is entitled to the refund under the provisions of this bill.

The broad definition of qualified person may be contrary to the author's intent. If the author intends the refund to be available to a specific type of taxpayer, such as a multistate corporation (a corporation that does business within and without California), the definition of qualified person should be amended.

Technical Considerations

For clarity, the following changes are recommended:

- On page 3, line 26, the phrase "on and after" should be replaced with the phrase "on or after."
- On page 4, line 33, the term "qualified" should be added before "sales tax" and before "use tax."
- On page 4, line 36, the term "qualified" should be added before "sales tax."
- On page 4, line 37, the term "qualified" should be added before "use tax."
- On page 4, line 38, the phrase "personal or corporation tax" should be deleted.

Policy Concerns

The bill does not specify a time period in which the claim for refund can be submitted to the CDTFA. Taxpayers typically must file a claim within a specified time period to limit the number of claims that can be received and processed.

The bill does not specify a beginning date that the SUT must be paid. As a result, refunds may be allowed for SUT paid in previous tax years.

LEGISLATIVE HISTORY

SB 855 (Committee on Budget and Fiscal Review, Chapter 52, Statutes of 2018), under the Personal Income Tax Law (PITL) and CTL, among other provisions, extended the CCTC to include taxable years before January 1, 2030.

SB 871 (Committee on Budget and Fiscal Review, Chapter 54, Statutes of 2018) established, under the PITL and CTL, the motion picture credit, for taxable years beginning on or after January 1, 2020, to be allocated by the California Film Commission on or after July 1, 2020, and before July 1, 2025. In addition, SB 871 allows, under the Sales and Use Tax provisions of the R&TC, for taxable years beginning on or after January 1, 2020, application of the credit against the SUT.

AB 93 (Committee on Budget, Chapter 69, Statutes of 2013), under the PITL and CTL, established the CCTC, for taxable years beginning on or after January 1, 2014, and before January 1, 2025.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The FTB'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 impact:

Estimated Revenue Impact of SB 1357 as Introduced on February 21, 2020
Assumed Enactment after June 30, 2020

(\$ in Millions)

Fiscal Year	Revenue*
2020-2021	-\$45
2021-2022	-\$120
2022-2023	-\$140

**The revenue impact is the result of the accelerated benefits that taxpayers would not have been otherwise entitled to without this election.*

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.

Because the impact of current economic circumstances is unknown, this estimate is subject to change.

Revenue Discussion

It is assumed for purposes of this bill that taxpayers would not elect to use their R&D Credits and/or CCTC to file claims for refunds for paid SUT if it would result in an overall increase in their total income and franchise tax liability. It is expected that taxpayers would elect to use their R&D and CCTC to refund their SUT only if they have sufficient amounts of other credits that they could apply to their income or franchise tax return that would allow them to maintain their same tax after credits balance. Therefore, the revenue impact of this bill is the amount of other tax credits applied in the current year that will no longer be available for use in future years. For taxable year 2021, it is estimated that taxpayers would elect refunds for paid SUT of approximately \$115 million. This amount will be offset by the use of \$115 million of other available credits.

The tax year estimates are grown, converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE STAFF CONTACT

Toni Arnold
Legislative Analyst, FTB
(916) 845-4743
toni.arnold@ftb.ca.gov

Tiffany Christiansen
Revenue Manager, FTB
(916) 845-5346
tiffany.christiansen@ftb.ca.gov

Annette Kunze
Legislative Director, FTB
(916) 845-6333
annette.kunze@ftb.ca.gov