DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: May 18, 2010
POSITION: Oppose

BILL NUMBER: AB 2640
AUTHOR: J. Arambula
RELATED BILLS: SB 445, Chapter 881, Statutes of 1993 (SB 671)

<u>BILL SUMMARY</u>: Income Taxes: Manufacturer Tax Credit: Parking Credit

This bill would, for tax years beginning January 1, 2011, and before January 1, 2016, 1) create a tax credit for purchases of certain property by manufacturers and 2) eliminate qualified parking from the federal conformity list of items excluded from gross income when provided to an employee from an employer.

<u>FISCAL SUMMARY</u>

The Franchise Tax Board (FTB) estimates net revenue gains of $34 million in 2010-11, $20 million in 2011-12, and $15 million in 2012-13.

At the time of this analysis, FTB had not prepared a cost estimate for this bill. However, the FTB notes that the implementation costs associated with the May 18, 2010 version of AB 2640 would be similar to those of Chapter 12, Statutes of 2010 (AB 183). The FTB estimated implementation costs in that bill of $1.3 million in 2010-11.

This bill would likely not impact Board of Equalization (BOE) costs. The FTB notes that although the tax credit would involve the taxpayer providing proof of sales tax remitted, FTB would not likely require backup information from the BOE. The FTB feels that a purchase receipt, invoice, and/or description would likely satisfy FTB in terms of qualifying the property for the income credit for sales tax paid.

<u>COMMENTS</u>

The Department of Finance is opposed to this bill for the following reasons:

- This bill creates a substantial tax increase on employees at a time when many are receiving less pay due to the recession.
- The non-conformity to federal law on taxation of employee parking would be complicated to administer for both businesses and the FTB. Regulations to determine the valuation of the fringe benefit of employee parking would be complicated and uncertain.
- Compliance with the elimination of qualified parking from gross income would likely be problematic.
- This bill is providing a tax credit and, at the same time, eliminating an exclusion from income. Finance feels that these issues should not be combined into one bill, but should be looked at separately.
- This bill singles out the manufacturing sector as the beneficiary of the tax credit. In the tough economy all industries in the state face, singling out one industry for a tax break seems inequitable.
- If looked at separately, the tax credit for manufacturers would result in significant revenue loss to the state.
- This bill is changing federal tax conformity on one issue, which offsets the revenue losses of a completely separate issue. Finance believes that federal conformity issues should be viewed in terms of other conformity items, not unrelated tax changes.

Analyst/Principal	Date	Program Budget Manager	Date
(0723) C. Angaretis		Mark Hill	

Department Deputy Director	Date

Governor's Office:	By:	Date:	Position Approved_______
			Position Disapproved

AUTHOR	AMENDMENT DATE	BILL NUMBER
J. Arambula	May 18, 2010	AB 2640

ANALYSIS

A. Programmatic Analysis

1) Tax Credit

Current state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Current federal law does not provide a tax credit comparable to that proposed by this bill.

Prior state law allowed qualified taxpayers a Manufacturers' Investment Credit (MIC) equal to 6 percent of the amount paid or incurred after January 1, 1994, and before January 1, 2004, for qualified property that was placed in service in California. For purposes of the MIC, a qualified taxpayer was any taxpayer engaged in manufacturing activities described in specified codes listed in the Standard Industrial Classification (SIC) Manual, 1987 edition.

Current state law provides special tax incentives for taxpayers conducting business activities within geographically targeted economic development areas. These incentives include a sales or use tax credit allowed in an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an economic development area (except a Manufacturing Enhancement Area). The amount of the credit is limited to the tax attributable to economic development area income.

This bill would, for taxable years beginning on or after January 1, 2010, and before January 1, 2016, provide an income tax credit to qualified taxpayers for the purchases of qualified property that is placed in service in California. The amount of the credit would be for the full amount of the total sales tax reimbursement or use tax paid on a purchase of qualified property, the revenues of which are deposited in the General Fund.

This bill defines a "qualified taxpayer" as a taxpayer primarily engaged in any of those lines of business properly classified under Codes 311111 to 339999 (manufacturing), inclusive, of the North American Industry Classification System (NAICS) Manual published by the United States Office of Management and Budget, 2007 edition. Taxpayers "primarily" engaged in theses classifications are defined as meaning 50 percent or more of the business consists of any line of business falling within these NAICS codes.

This bill defines a "qualified property" defined in Internal Revenue Code (IRC) Section 1245(a)(3). This can include tangible personal property (excluding buildings and inventory) that is subject to depreciation. This would include most equipment and furnishings.

This bill also provides that:

- The credit shall only be allowed for the taxable year the property is placed in service.
- Any excess credit may be carried over to reduce the net tax in the following year, and succeeding eight years, until the credit is exhausted.
- To reserve the credit, a taxpayer will apply to FTB, as specified.
- The total amount of credit to be allocated will not exceed $100 million. The FTB will adjust this amount annually for inflation.

AUTHOR	**AMENDMENT DATE**	**BILL NUMBER**
J. Arambula	May 18, 2010	AB 2640

- A qualified taxpayer will notify the FTB within 30 days after the qualified property is removed the state or is disposed of to an unrelated party in the same taxable year. No credit will be allowed in this case and in cases where the property is removed or disposed of in the taxable year following the taxable year the property is first placed in service.
- In cases of disallowed credit, the amount of the credit would be recaptured by adding that credit to the net tax of the qualified taxpayer in the taxable year in which the property is disposed or removed.

This provision would result in revenue losses of $21 million in 2010-11, $80 million in 2011-12, and $95 million in 2012-13.

2) Eliminate Income Exclusions for Transportation Benefits

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.

Federal law allows employees certain exclusions from gross income for the value of qualified transportation fringe benefits, including employer-provided qualified parking. The term “qualified parking” means parking provided to an employee by an employer (1) on or near the business premises of the employer or (2) at location from which the employee commutes to work by car pool, commuter highway vehicle, mass transit, or transportation provided by any person in the business of transporting persons for compensation or hire, but only if the seating capacity of such transportation accommodates at least six adults, excluding the driver. Parking at or near an employee’s residence is not qualified parking. The current maximum monthly value of qualified parking that can be excluded from an employee’s gross income is $230. This amount is adjusted for inflation annually.

Current state law conforms to federal law and allows certain exclusions from gross income for the value of qualified transportation fringe benefits, including employer-provided qualified parking. In addition, California law provides an exclusion from gross income of any benefit, except salary or wages, received by an employee from an employer for participation in any ridesharing arrangement in California, including free or subsidized parking. The phrase “free or subsidized parking” means the benefit received from an employer for parking while participating in a ridesharing arrangement within California. Ridesharing arrangements include carpools, vanpools, and buspools. There is no maximum monthly amount that may be excluded from gross income for benefits received for participating in ridesharing arrangements in California.

This bill would, for taxable years beginning on or after January 1, 2011, and before January 1, 2016, remove the federal conformity exclusion for qualified parking, as defined by Section 132(f)(1)(C) of the IRC, from the list of items excluded from gross income. The IRC defines qualified parking as parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work.

This provision would result in revenue gains of $55 million in 2010-11, $100 million in 2011-12, and $110 million in 2012-13.

B. Fiscal Analysis

The FTB estimates net revenue gains of $34 million in 2010-11, $20 million in 2011-12, and $15 million in 2012-13.

AUTHOR	**AMENDMENT DATE**	**BILL NUMBER**
J. Arambula	May 18, 2010	AB 2640

At the time of this analysis, FTB had not prepared a cost estimate for this bill. However, the FTB notes that the implementation costs associated with the May 18, 2010 version of AB 2640 would be similar to those of Chapter 12, Statutes of 2010 (AB 183). The FTB estimated implementation costs in that bill of $1.3 million in 2010-11.

This bill would likely not impact BOE costs. The FTB notes that although the property tax credit would involve the taxpayer providing proof of sales tax remitted, FTB would not likely require backup information from the BOE. The FTB feels that a purchase receipt, invoice, and/or description would likely satisfy FTB in terms of qualifying the property for the income credit for sales tax paid.

	SO	(Fiscal Impact by Fiscal Year)							
Code/Department	LA	(Dollars in Thousands)							
Agency or Revenue	CO	PROP							Fund
Type	RV	98	FC	2009-2010	FC	2010-2011	FC	2011-2012	Code
1147/Pers Inc Tax	RV	No		--	U	$34,000	U	$20,000	0001
1730/FTB	SO	No		--	C	$1,300		--	0001