



Tax Policy Priorities – 2007

FAVORABLE SALES APPORTIONMENT FACTOR FORMULA (*Leadership Group supports*)

The California Franchise Tax Board uses a three-factor formula to “apportion” a corporation’s income between California and other states. Existing state tax law requires corporations that operate in more than one state to calculate their taxable income based on the proportion of their overall sales, payroll, and property that are located in the state. The economic effect of the three-factor formula is to convert corporate tax into three separate taxes – a tax on jobs, a tax on business investment, and a tax on gross receipts. Under a more favorable sales apportionment factor, employers would calculate their taxable income in California based only on their sales in the state, and would not include property and payroll as they do now. This means multi-state corporations would be taxed based only on sales, instead of the current combination of sales, property, and payroll.

Today’s reality is that whenever a corporation acts to create additional jobs or increase plant size, or invest in equipment in this state, its California corporate tax bill will go up. When instead the corporation invests in another state with a single sales factor, its corporate income tax bill will be unaffected in that other state, but will decrease in California. While business location decisions are based on a number of factors, differing tax treatments among states can have a big impact on such decisions, especially when other factors are satisfied by multiple locations.

If California adopts an elective sales factor apportionment formula, economic analysis indicates that the impact on employment, income, and output within the state will be positive due to two consequences of the formula change: 1) Increasing the incentive to invest in California, rather than in other states; and 2) By alleviating the current penalty of the added corporate tax burden on companies investing in California jobs and facilities. An elective sales factor apportionment formula will increase the ability of these firms to retain and create new jobs, and invest in state-of-the-art facilities. Ultimately, this will clearly give California an economic boost. The Leadership Group supports an elective sales apportionment factor formula.

RESEARCH AND DEVELOPMENT (R&D) TAX CREDIT (*Leadership Group supports*)

The R&D credit enables high-tech companies, among others, to undertake substantial R&D projects that otherwise might not occur, or occur as soon. More potential research projects typically exist than the dollars available to fund them - certainly for small companies, and even large ones. The R&D credit provides U.S. high-tech companies with the ability to continue to make significant R&D investments and provide the front end innovation to drive the economy.

Congress has recently passed, and the President has signed, an extension and enhancement of the Research and Development Tax Credit. The Federal R&D bill extends the credit for the period of 1/1/06 through 12/31/07. It increases the rates of the Alternative Incremental Research Credit (AIRC) for '07, and also for '07 adds another alternative credit, called the Alternative Simplified Credit (ASC). California should adopt the following:

- 1) incorporate the new alternative federal research credit – ASC – in CA law (for California research);
- 2) clarify legislative intent to allow the R&D credit to be shared among a unitary group of companies (in accord with recent GM decision by the California Supreme Court mandating that specific legislative language is required to achieve this result);
- 3) provide a sales and use tax exemption for new productive assets utilized to conduct California research; and
- 4) increase the current R&D credit rate from 15 to 20% (as was proposed in the '06 session as well).

The Leadership Group has long supported the R&D tax credit and urge California leaders to push for simplification, modernization and permanency. Currently the California credit includes the AIRC, but given the recent increase in the rates of the federal AIRC, an increase in the rates here should also be considered.

SALES TAX EXEMPTION FOR MANUFACTURING EQUIPMENT (*Leadership Group supports*)

California “double taxes” both business inputs (manufacturing and related research) and business outputs (the products from the utilization of these assets). Virtually no other state taxes both. Currently, 42 other states – our competition – offer an exemption on sales taxes paid for such purchases. The eight states that do not provide some form of a sales tax exemption for these activities typically have very limited manufacturing or high-tech activity. These investments are critical to the future health of California’s economy because they would greatly increase facility expansion and subsequent job growth. As a result of this proposal, job providers would not have to pay a portion of their state sales taxes when purchasing such assets. Recognizing varying situations of local budgets that rely on sales tax revenues to fund local services, the exemption would not apply to the local portion of sales and use tax. The Leadership Group supports exempting sales corporate sales taxes for purchases of manufacturing and R&D equipment.