

REPORT OF THE CHIEF LEGISLATIVE ANALYST

DATE: April 11, 2013

TO: Honorable Members of the Rules, Elections and Intergovernmental Relations
Committee

FROM: Gerry F. Miller *KEF*
Chief Legislative Analyst

Council File No: 13-0002-S34
Assignment No: 13-03-0179

SUBJECT: Resolution (Rosendahl-Zine, et al.) to SUPPORT SB 500 (Lieu).

CLA RECOMMENDATION: Adopt Resolution (Rosendahl-Zine, et al.) to include in the City's 2013-2014 State Legislative Program SUPPORT for SB 500 (Lieu), which would increase the California research and development tax credit from 15 to 20 percent and provide complete conformity to the alternative incremental credit under federal income tax laws.

SUMMARY

Resolution (Rosendahl-Zine, et al.), introduced on March 5, 2013, describes the State of California 15 percent income and corporate tax credit that rewards companies that make research and development (R&D) investments. The Resolution states that businesses in the State account for more than one-fifth of total R&D investments in the U.S. Citing that countries such as China and India have significantly increased their efforts to expand their research and development capabilities, the Resolution introduces SB 500, which expands the State's tax credit from 15 to 20 percent and conforms the State's research credit with federal tax laws. Because SB 500 would encourage the creation of more high-skilled, high-paying jobs, the Resolution resolves that the City support SB 500.

BACKGROUND

Federal and California tax laws currently offer credits designed to provide incentives for research and development activities. Below is a summary of these federal and state laws:

Federal Law

The Federal research credit for personal income tax and corporate tax is determined as the sum of the following:

1. 20 percent of the qualified research expenses incurred during the taxable year that exceed the base amount, and
2. 20 percent of the amount paid or incurred during the taxable year on research undertaken by an energy research consortium.

Corporate taxpayers are also allowed a credit of 20 percent of expenses paid to fund basic research at universities and certain nonprofit scientific research organizations.

To qualify for the credit, the research must be experimental or laboratory and be conducted in the United States, among other requirements. The federal credit was extended through 2013 in the American Taxpayer Relief Act of 2012.

State Law

California's credit for research activities was introduced in 1988. As in the federal credit, the California Research and Development Credit provides tax savings for both personal and corporate tax. California conforms to the federal credit with the following notable differences:

- The credit for qualified research is 15 percent as opposed to 20 percent;
- The credit for basic research is 24 percent versus 20 percent, however eligible recipients are restricted; and
- Research must be conducted in California.

According to the National Science Board (NSB), in 2008 California had a total research and development expenditure of \$81.3 billion, accounting for 22 percent of the U.S. total, exceeding each of the next three highest states by about a factor of four. While California leads the nation in research and development activity, the state has steadily lost manufacturing jobs to other states and countries such as China and India, which have taken actions to make themselves more attractive to these businesses. The U.S. Bureau of Labor Statistics reports that California lost approximately 425,000 manufacturing jobs from 2002 to 2012. The NSB further reports that from 2003-2009, about 85 percent of the growth in research and development workers employed by U.S.-based multinational companies was abroad. Business groups including the California Chamber of Commerce and Silicon Valley Leadership Group have pointed out the inconsistencies between the California and federal research and development credit and have advocated that action be taken to both increase the state credit and broaden the group of businesses eligible to use the credit in order to strengthen California's manufacturing sector.


SB 500 would increase the state's R&D credit to 20 percent of the excess of qualified research expenses. This bill would also provide complete conformity to the alternative incremental credit provided under federal law, broadening the group of businesses who would qualify for the credit. This bill is the latest attempt at increasing the credit; similar bills have been introduced in the Assembly and Senate nearly every year since 2001 and have failed to become law. According to the California Chamber of Commerce, the increase of the R&D tax credit will help California maintain and expand its leading edge in research and development, stimulate the economy by encouraging additional investments and jobs, and allow the state to compete with other states and countries. Therefore, we recommend support of SB 500. At the writing of this report, the California Franchise Tax Board had yet to release its analysis of the bill; therefore, the fiscal impact to the State's budget is not available at this time.

DEPARTMENTS NOTIFIED

N/A

BILL STATUS

02/21/13	Introduced
03/11/13	Referred to Committee on Government and Finance



Clay McCarter
Analyst

Attachment: 1. Resolution (Rosendahl-Zine, et al.)

13-0002-534

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RESOLUTION RULES, ELECTIONS & INTERGOVERNMENTAL RELATIONS

WHEREAS, any official position of the City of Los Angeles with respect to legislation, rules, regulations, or policies proposed to or pending before a local, state or federal government body or agency must have first been adopted in the form of a Resolution by the City Council with the concurrence of the Mayor; and

WHEREAS, the State of California recognized the value of encouraging businesses to invest in research and development to help create new products and services and to improve existing products and processes by enacting an income and corporate tax credit in 1986 that rewards companies that make these investments by offering them a tax credit of 15% of "excess qualified research and development expenses," as defined in the law; and

WHEREAS, reports show that businesses in the State of California account for more than one-fifth of total research and development investments in the United States; California universities rank fifth among all universities in R&D; and three states - California, Massachusetts, and Texas - account for more than half of all research and development on computer and electronics products in the United States; and

WHEREAS, countries such as China and India also recognize the value of R&D investments, and have significantly increased their efforts to expand research and development in their respective countries, which has lead some businesses in the Silicon Valley to relocate certain operations to those countries; and

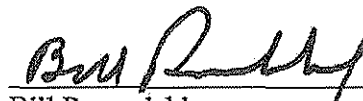
WHEREAS, Senator Ted W. Lieu, recognizing the need to keep California as a leader in research and development, has introduced Senate Bill 500 to expand the State's tax credit from 15% to 20% of excess qualified research and development expenses, and to conform the State's alternative incremental research credit with federal tax laws; and

WHEREAS, when fully implemented, SB 500 would encourage the creation of more high-skill, high-paying jobs in the State; and

WHEREAS, the Los Angeles City Council has historically supported efforts to encourage research and development in the City, in such areas as technology, renewable energy, and alternative fuels.

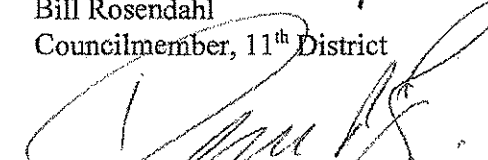

NOW, THEREFORE, BE IT RESOLVED, with the concurrence of the Mayor, that by the adoption of this Resolution, the City of Los Angeles hereby includes in its 2013-14 State Legislative Program SUPPORT for Senate Bill 500, authored by Senator Lieu, to encourage businesses in California to expand their investment in research and development by offering improved tax credits to reward those efforts.

PRESENTED BY:


Bill Rosendahl
Councilmember, 11th District


MAR 5 2013

SECONDED BY:

ORIGINAL