Assembly Bill No. 437

Passed the Assembly September 2, 2015

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Chief Clerk of the Assembly

Passed the Senate September 1, 2015

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Secretary of the Senate

This bill was received by the Governor this _____ day of _____, 2015, at _____ o'clock ___M.

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Private Secretary of the Governor

CHAPTER _____

An act to amend Sections 17052.12 and 23609 of, to add Sections 17131.8 and 24304 to, and to add and repeal Division 3 (commencing with Section 70000) of, the Revenue and Taxation Code, relating to small businesses, and making an appropriation therefor.

LEGISLATIVE COUNSEL'S DIGEST

AB 437, Atkins. Research and Development: Small Business Grant Program.

Existing law provides for several programs supporting small businesses, including the Office of Small Business Advocate, the duties of director of which include, among other things, representing the views and interests of small businesses before other state agencies whose policies and activities may affect small businesses.

The Personal Income Tax Law imposes taxes on taxable income at specified rates based upon the amount of taxable income. The Corporation Tax Law imposes taxes upon, according to, or measured by, net income, as specified. The Personal Income Tax Law and the Corporation Tax Law, in modified conformity to a credit allowed under federal law, allow a credit against taxes imposed by those laws for increasing research expenses, as defined. Existing law allows a taxpayer to carryover any excess amounts of that credit to succeeding taxable years, until the credit is exhausted.

This bill would, beginning January 1, 2017, and ending January 1, 2024, establish the Research and Development-Small Business Grant Program, which would provide qualified small businesses, as defined, grants in amounts equal to either 10% or 15% of any excess credit amount attributable to the small business for specified years under the credit described above. This bill would continuously appropriate moneys from the General Fund to award these grants, in specified amounts per calendar year, to be allocated by the Franchise Tax Board. This bill would specify that any grant money received by a qualified small business would be excluded from its income and would provide that any excess credit amount

attributable to the qualified small business would be reduced by the amount allowed as a grant.

Appropriation: yes.

The people of the State of California do enact as follows:

SECTION 1. Section 17052.12 of the Revenue and Taxation Code is amended to read:

17052.12. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the "net tax," as defined by Section 17039, an amount determined in accordance with Section 41 of the Internal Revenue Code, relating to credit for increasing research activities, except as follows:

(a) For each taxable year beginning before January 1, 1997, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "8 percent."

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "11 percent."

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "12 percent."

(3) For each taxable year beginning on or after January 1, 2000, the reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "15 percent."

(c) Section 41(a)(2) of the Internal Revenue Code shall not apply.

(d) "Qualified research" shall include only research conducted in California.

(e) (1) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.

(2) For taxable years beginning on or after January 1, 2017, in the case where the Franchise Tax Board has issued a certificate for a grant pursuant to Division 3 (commencing with Section 70000) the following rules shall apply:

(A) The excess credit amount that may be carried over by a taxpayer shall be reduced by the amount reflected on the certificate.

(B) (i) In the case of a pass-thru entity, the amount of credit that may be passed through to a partner or shareholder shall be reduced by the amount reflected on the certificate.

(ii) For purposes of this subparagraph, "pass-thru entity" means a partnership or an "S" corporation.

(C) If any amount of a credit finally allowed is less than the amount of the credit that provided the basis for a grant pursuant to Division 3 (commencing with Section 70000), the amount of the grant attributable to the credit not allowed shall be treated as a deficiency pursuant to Section 19043, and assessed and collected pursuant to Part 10.2 (commencing with Section 18401).

(f) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code, relating to qualified research expenses, is modified to exclude from the definition of "qualified research expense" any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) For each taxable year beginning on or after January 1, 1998, the reference to "Section 501(a)" in Section 41(b)(3)(C) of the Internal Revenue Code, relating to amounts paid to certain research consortia, is modified to read "this part or Part 11 (commencing with Section 23001)."

(g) (1) For each taxable year beginning on or after January 1, 2000:

(A) The reference to "3 percent" in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read "one and forty-nine hundredths of one percent."

(B) The reference to "4 percent" in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read "one and ninety-eight hundredths of one percent."

(C) The reference to "5 percent" in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read "two and forty-eight hundredths of one percent."

(2) Section 41(c)(4)(B) of the Internal Revenue Code, relating to election, shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code, relating to in general, may be made for any taxable year of the taxpayer

beginning on or after January 1, 1998. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

(3) Section 41(c)(7) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(4) Section 41(c)(5) of the Internal Revenue Code, relating to election of alternative simplified credit, shall not apply.

(h) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(i) Section 41(g) of the Internal Revenue Code, relating to special rule for pass-thru of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code, relating to general rule, for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, relating to special rule for pass-thru of credit, that amount may be carried over to other taxable years under the rules of subdivision (e); except that the limitation of Section 41(g) of the Internal Revenue Code, relating to special rule for pass-thru of credit, shall be taken into account in each subsequent taxable year.

(j) Section 41(a)(3) of the Internal Revenue Code shall not apply.

(k) Section 41(b)(3)(D) of the Internal Revenue Code, relating to amounts paid to eligible small businesses, universities, and Federal laboratories, shall not apply.

(*l*) Section 41(f)(6), of the Internal Revenue Code relating to energy research consortium, shall not apply.

SEC. 2. Section 17131.8 is added to the Revenue and Taxation Code, to read:

17131.8. For taxable years beginning on or after January 1, 2017, and before January 1, 2024, gross income does not include any grant received by a taxpayer pursuant to Division 3 (commencing with Section 70000).

SEC. 3. Section 23609 of the Revenue and Taxation Code is amended to read:

23609. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the "tax," defined by Section 23036, an amount determined in accordance with Section 41 of the Internal Revenue Code, relating to credit for increasing research activities, except as follows:

(a) For each taxable year beginning before January 1, 1997, both of the following modifications shall apply:

(1) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "8 percent."

(2) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "12 percent."

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, both of the following modifications shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "11 percent."

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, both of the following shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "12 percent."

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(3) For each taxable year beginning on or after January 1, 2000, both of the following shall apply:

(A) The reference to "20 percent" in Section 41(a)(1) of the Internal Revenue Code is modified to read "15 percent."

(B) The reference to "20 percent" in Section 41(a)(2) of the Internal Revenue Code is modified to read "24 percent."

(c) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code, relating to qualified research expenses, is modified to exclude from the definition of "qualified research expense" any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) "Qualified research" and "basic research" shall include only research conducted in California.

(d) The provisions of Section 41(e)(7)(A) of the Internal Revenue Code, relating to basic research, shall be modified so that "basic research," for purposes of this section, includes any basic or applied research including scientific inquiry or original investigation for the advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except that the term does not include any of the following:

(1) Basic research conducted outside California.

(2) Basic research in the social sciences, arts, or humanities.

(3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.

(4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(e) (1) In the case of a taxpayer engaged in any biopharmaceutical research activities that are described in codes 2833 to 2836, inclusive, or any research activities that are described in codes 3826, 3829, or 3841 to 3845, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, or any other biotechnology research and development activities, the provisions of Section 41(e)(6) of the Internal Revenue Code, relating to qualified organization, shall be modified to include both of the following:

(A) A qualified organization as described in Section 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an institution of higher education as described in Section 3304(f) of the Internal Revenue Code, relating to definition of institution of higher education.

(B) A charitable research hospital owned by an organization that is described in Section 501(c)(3) of the Internal Revenue Code, is exempt from taxation under Section 501(a) of the Internal Revenue Code, relating to exempt from taxation, is not a private foundation, is designated a "specialized laboratory cancer center," and has received Clinical Cancer Research Center status from the National Cancer Institute.

(2) For purposes of this subdivision:

(A) "Biopharmaceutical research activities" means those activities that use organisms or materials derived from organisms,

and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.

(B) "Other biotechnology research and development activities" means research and development activities consisting of the application of recombinant DNA technology to produce commercial products, as well as research and development activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(f) (1) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years if necessary, until the credit has been exhausted.

(2) For taxable years beginning on or after January 1, 2017, in the case where the Franchise Tax Board has issued a certificate for a grant pursuant to Division 3 (commencing with Section 70000) the following rules shall apply:

(A) The excess credit amount that may be carried over by a taxpayer shall be reduced by the amount reflected on the certificate.

(B) (i) In the case of a pass-thru entity, the amount of credit that may be passed through to a partner, taxable under this part, shall be reduced by the amount reflected on the certificate.

(ii) For purposes of this subparagraph, "pass-thru entity" means a partnership.

(C) If any amount of a credit finally allowed is less than the amount of the credit that provided the basis for a grant pursuant to Division 3 (commencing with Section 70000), the amount of the grant attributable to the credit not allowed shall be treated as a deficiency pursuant to Section 19043, and assessed and collected pursuant to Part 10.2 (commencing with Section 18401).

(g) For each taxable year beginning on or after January 1, 1998, the reference to "Section 501(a)" in Section 41(b)(3)(C) of the Internal Revenue Code, relating to amounts paid to certain research consortia, is modified to read "this part or Part 10 (commencing with Section 17001)."

(h) (1) For each taxable year beginning on or after January 1, 2000:

(A) The reference to "3 percent" in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read "one and forty-nine hundredths of one percent."

(B) The reference to "4 percent" in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read "one and ninety-eight hundredths of one percent."

(C) The reference to "5 percent" in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read "two and forty-eight hundredths of one percent."

(2) Section 41(c)(4)(B) of the Internal Revenue Code, relating to election, shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code, relating to in general, may be made for any taxable year of the taxpayer beginning on or after January 1, 1998. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

(3) Section 41(c)(7) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(4) Section 41(c)(5) of the Internal Revenue Code, relating to election of alternative simplified credit, shall not apply.

(i) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(j) Section 41(g) of the Internal Revenue Code, relating to special rule for pass-thru of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code, relating to general rule, for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, relating to special rule for pass-thru of credit, that amount may be carried over to other taxable years under the rules of subdivision (f), except that the limitation of Section 41(g) of the Internal Revenue Code, relating to special rule for pass-thru of credit, shall be taken into account in each subsequent taxable year.

(k) Section 41(a)(3) of the Internal Revenue Code shall not apply.

(*l*) Section 41(b)(3)(D) of the Internal Revenue Code, relating to amounts paid to eligible small businesses, universities, and Federal laboratories, shall not apply.

(m) Section 41(f)(6) of the Internal Revenue Code, relating to energy research consortium, shall not apply.

SEC. 4. Section 24304 is added to the Revenue and Taxation Code, to read:

24304. For taxable years beginning on or after January 1, 2017, and before January 1, 2024, any grant received by a taxpayer pursuant to Division 3 (commencing with Section 70000).

SEC. 5. Division 3 (commencing with Section 70000) is added to the Revenue and Taxation Code, to read:

DIVISION 3. RESEARCH AND DEVELOPMENT-SMALL BUSINESS GRANT PROGRAM

70000. For purposes of this division:

(a) (1) Except as provided in paragraph (2), "excess credit amount" means the amount of credit under Section 17052.12 or 23609 that exceeds the "net tax," as defined by Section 17039, or the "tax," as defined by Section 23036, as applicable, for the first taxable year the credit is allowable and may be carried over to reduce "net tax" or "tax," as applicable, in the following taxable year.

(2) In the case of a pass-thru entity, for credits attributable to taxable years beginning on or after January 1, 2017, "excess credit amount" means the amount of credit allowed under Section 17052.12 or 23609 to be passed through to partners or shareholders.

(b) "Qualified small business" means a taxpayer that meets all of the following requirements for the taxable year with respect to the credit for which a grant is authorized under this division:

(1) The taxpayer was allowed a credit under either Section 17052.12 or 23609.

(2) The taxpayer has gross receipts of five million dollars ($5,000,000) or less for the taxable year. For purposes of this paragraph, "gross receipts" has the same definition as in Section 41(c)(7) of the Internal Revenue Code, relating to gross receipts, modified to provide that the last sentence shall not apply.

(3) (A) The taxpayer is not an affiliated corporation that is properly treated as a member of a combined reporting group pursuant to Section 25101 or 25110.

(B) Notwithstanding any other provision, no grant may be awarded pursuant to this division with respect to a credit that may be assigned pursuant to Section 23663.

(4) Is organized as one of the following business entities:

(A) A corporation.

(B) A partnership.

(C) A limited partnership.

(D) A limited liability company, whether classified as a corporation, partnership, or disregarded as a separate entity.

(5) Was in existence and filed income tax returns under Part 10.2 (commencing with Section 18401) of Division 2 for the two taxable years preceding the taxable year for which the taxpayer applies for a grant under Section 70001.

70001. (a) On or after January 1, 2017, and before January 1, 2024, a qualified small business may apply for a grant as follows:

(1) Beginning January 1, 2017, a qualified small business may apply for and receive a one-time grant in an amount equal to 10 percent of any excess credit amount that is attributable to taxable years beginning on or after January 1, 2015, and before January 1, 2017, available for carryover into taxable years beginning on or after January 1, 2017, for credits allowed under Section 17052.12 or 23609.

(2) For taxable years beginning on or after January 1, 2017, and before January 1, 2022, a qualified small business may annually apply for a grant in an amount equal to 15 percent of any excess credit amount attributable to the taxable year in which the credit is allowed under Section 17052.12 or 23609.

(b) (1) In order to receive a grant under paragraph (1) of subdivision (a), the qualified small business, partner, or “S” corporation shareholder of a qualified small business shall be required to apply for a grant on a timely filed original return filed with the Franchise Tax Board using electronic technology in a form and manner prescribed by the Franchise Tax Board for the taxable year beginning on or after January 1, 2016, by applying to the Franchise Tax Board for a certificate indicating the amount equal to 10 percent of the excess credit amount that is attributable to taxable years beginning on or after January 1, 2015, and before

January 1, 2017, available for carryover into taxable years beginning on or after January 1, 2017, for a credit allowed under Section 17052.12 or 23609. The Franchise Tax Board shall supply the qualified small business with a certificate within 90 days of receiving the return with the application.

(2) In order to receive a grant under paragraph (2) of subdivision (a), the qualified small business shall be required to apply for a grant on a timely filed original return with the Franchise Tax Board using electronic technology in a form and manner prescribed by the Franchise Tax Board for each taxable year beginning on or after January 1, 2017, by applying to the Franchise Tax Board for a certificate indicating the amount equal to 15 percent of the excess credit amount that is attributable to the taxable year in which a credit is allowed under Section 17052.12 or 23609, and available for carryover to the following year. The Franchise Tax Board shall supply the qualified small business with a certificate within 90 days of receiving the return.

(c) (1) The Franchise Tax Board shall allocate the certified amounts based on the aggregate applicable amount for the calendar year in which the certificate is issued.

(2) The aggregate applicable amount that may be certified for the calendar year beginning January 1, 2017, shall be one hundred million dollars ($100,000,000), not to exceed fifty million dollars ($50,000,000) for each taxable year beginning January 1, 2015, and January 1, 2016.

(3) The aggregate applicable amount shall not exceed fifty million dollars ($50,000,000) for each calendar year beginning on or after January 1, 2018, and before January 1, 2024, regardless of the taxable year to which the grant relates.

(4) (A) The Franchise Tax Board shall allocate the certificates to the qualified small business, partners, or “S” corporation shareholder, as applicable, on a first-come-first-served basis, determined by the date the taxpayer’s original tax return is received by the Franchise Tax Board. If the returns of two or more qualified small businesses are received on the same day and the amount of credit remaining to be allocated is insufficient to be allocated fully to each, the credit remaining shall be allocated to those qualified small businesses on a pro rata basis.

(B) For purposes of this paragraph, the date a return is received shall be determined by the Franchise Tax Board. The determination

of the Franchise Tax Board as to the date a return is received and whether a return has been timely filed for purposes of this paragraph may not be reviewed in any administrative or judicial proceeding.

(d) In the case of a qualified small business that is a pass-thru entity, the following shall apply:

(1) (A) For purposes of the credit allowed under Section 17052.12, a "pass-thru entity" means a partnership or an "S" corporation.

(B) For purposes of the credit allowed under Section 23609, a "pass-thru entity" means a partnership.

(2) (A) For grants with respect to taxable years beginning on or after January 1, 2015, and before January 1, 2017, the Franchise Tax Board shall issue the certificate to the qualified small business, partners, or "S" corporation shareholders, as applicable.

(B) For grants with respect to taxable years beginning on or after January 1, 2017, the Franchise Tax Board shall issue the certificate to the partnership or "S" corporation.

(3) A certificate shall not be issued to an "S" corporation with respect to the credit allowed under Section 23609.

(e) To the extent the amount of the certificate issued by the Franchise Tax Board is based on a request from a qualified small business, partner, or "S" corporation shareholder, as applicable, any amount of a credit finally allowed that is less than the amount of the credit that provided the basis for a grant under this division, the amount of the grant attributable to the credit not allowed shall be treated as a deficiency pursuant to Section 19043, and assessed and collected pursuant to Part 10.2 (commencing with Section 18401).

(f) The Franchise Tax Board may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this division, including any guidelines regarding the allocation of the certificates issued pursuant to this section. Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any rule, guideline, or procedure prescribed by the Franchise Tax Board pursuant to this section.

70002. (a) The Controller, upon a receipt of a certificate issued to a qualified small business, partner, or "S" corporation shareholder, as applicable, under Section 70001, shall pay the

qualified small business the grant amount indicated upon the certificate issued to the qualified small business, partner, or "S" corporation shareholder. Notwithstanding Section 13340 of the Government Code, the amounts necessary to provide the grants are hereby continuously appropriated from the General Fund.

(b) (1) Notwithstanding Article 2 (commencing with Section 19542) of Chapter 7 of Part 10.2 of Division 2 and Section 10231.5 of the Government Code, on or before January 1, 2018, and each January 1 thereafter, the Controller shall provide a report to the Assembly Committee on Revenue and Taxation and the Senate Committee on Governance and Finance, or its successor, including the recipients of the grants for the previous calendar year and the grant amount each recipient received.

(2) A report submitted pursuant to paragraph (1) shall be submitted in compliance with Section 9795 of the Government Code.

70003. This division shall remain in effect only until January 1, 2024, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2024, deletes or extends that date.

Approved _____, 2015

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Governor