Date:	April 18, 2017
To:	Members, Senate Governance and Finance Committee
From:	Therese Twomey, CalTax Fiscal Policy Director
Subject:	**SUPPORT for SB 600 (Galgiani), as amended on April 3, 2017**

The California Taxpayers Association and the listed organizations are writing in SUPPORT of SB 600, which would enhance the existing manufacturing and research-and-development incentive program to draw to the state high-paying jobs from across multiple industry segments and to fuel our economic expansion into the next decade.

This measure furthers the objectives of the manufacturing/R&D equipment sales tax exemption program that was the cornerstone of the bipartisan Governor's Economic Development Initiative (GEDI) enacted in 2013 to "strengthen the state's economic development programs to bolster the business environment"… so the state "can encourage manufacturing investment and increase employment in high poverty areas across the state."[i]

With manufacturing slowly returning to the United States and the potential for more reshoring of jobs, California must position itself competitively. Otherwise, we will lose out on growth opportunities, potentially for the long term, as employers are less likely to relocate substantial infrastructure and workforce shortly after making new investments in other states. SB 600 delivers a clear message that California is committed to employers who are here, and is driven to attract those who are not.

Dollars and Sense

The sales tax exemption for manufacturing and R&D equipment more than pays for itself in terms of investment in the state. According to data from the State Board of Equalization (BOE), for every $1 of tax exemption, there has been a $23 return in new investment in equipment and infrastructure. Since the program's inception in 2014, employers have invested an aggregate $9.4 billion in qualified purchases.[ii]

Few of the state's existing programs can boast such results. That said, its continued success will depend on whether California can address program ambiguities and limitations, including expiration of the tax incentive slated for 2022.

For some employers, a tax incentive that goes away in five years may be of little value, as it could take that long before a project is complete, due to the state's environmental and other regulations. SB 600's extension of the tax exemption to 2030 improves tax certainty, which national surveys and reports consistently find to be a key factor in business expansion and relocation decisions.

This legislation also resolves a discrepancy regarding how taxpayers can prove that qualifying investments meet a "useful life" test, by adopting documentation alternatives – such as warranties, maintenance contracts and industry replacement standards – similar to those widely established in other states. While seemingly innocuous, this discrepancy has been interpreted to disqualify equipment purchases that otherwise would be eligible, and has presented a significant deterrent for incentivizing investments. Furthermore, the one-size-fits-all "useful life" method requiring tax depreciation adversely affects small businesses and promotes unfair disadvantages between competitors.

SB 600 provides a commonsense solution to both of these problems.

The Small Business Engine That Could

While many people relate manufacturing and research-and-development activities with medium-sized and larger businesses, these incentives help our small businesses and start-ups as well.

According to the U.S. Small Business Administration, the average start-up cost for a small business is approximately $30,000, but can run higher if the business requires more costly equipment. Securing start-up capital can be challenging, and a tax exemption on equipment purchased for use in manufacturing or production (i.e., commercial refrigeration system, mixer, and fryer for a donut shop) could go a long way to lessen the shop owner's burden of a state sales tax rate that is the highest in nation.[iii] It also would help get prospective businesses off the ground and would help existing businesses finance expansions.

Growing Season

California – the nation's leader in agricultural production and exports, feeding the country and the world – expressly prohibits its homegrown industry from a tax exemption for purchases of manufacturing and processing equipment. This prohibition was motivated by concerns that state costs would exceed revenue-neutral targets. However, state agency data shows otherwise – see "Roadmap to Revenue Neutrality" discussion below.

Given that costs are *below* the revenue-neutral targets, and recognizing that sustained support for the industry's $20 billion annual exports – including its manufacturing and processing – are crucial to the state's economic future, SB 600 expands the tax exemption to agricultural manufacturing and processing equipment.

Powering California

Tax incentives can be powerful tools to motivate energy producers to expand their renewable portfolio, and have a direct impact on electricity rates set by the California Public Utilities Commission (CPUC).

The governor's Renewable Portfolio Standards (RPS) require that at least 50 percent of retail sales of electricity by utilities be derived from renewable energy by the year 2030. While energy producers are working to meet that goal, California's electricity prices (already among the highest in the nation) are anticipated to rise – due to higher renewable-sourced production costs versus non-renewable; numerous state mandates (e.g., clean energy research, energy efficiency mandates, etc.); and fixed grid costs that are spread over fewer units sold as ratepayers move toward solar rooftops and adopt energy conservation measures.

SB 600's provisions authorizing a tax exemption for equipment used in electricity production and distribution provide a twofold benefit. First, electricity ratepayers benefit directly because reductions to utility capital expenditures reduce electricity prices set by the CPUC. This helps address affordability for both California households and businesses, especially those industries that consume more energy. Second, energy producers could make more investments in renewable energy generation if motivated by a tax incentive, and conceivably could do so ahead of the 2030 deadline under certain economic and supply-and-demand conditions. This means lower electricity rates and a greener California.

Roadmap to Revenue Neutrality

Improvements to the manufacturing and R&D sales tax exemption program are necessary to close the gap on the revenue-neutral targets established by the governor and the Legislature.

In 2013, SB 90 (approved in the Senate and Assembly 36-1 and 76-0, respectively) created the program as one of three revenue-neutral incentives to replace Enterprise Zone tax incentives. To achieve revenue-neutrality, utilization targets for the program were set for each year. Unfortunately, ambiguities and eligibility restrictions have confined utilization to less than 50 percent of target, based on BOE data. Projections from the Department of Finance show similar trends.

To ward against under-utilization, SB 90 required the BOE to compare actual utilization versus estimated. If actual utilization falls short of the estimated targets, the BOE must identify options for increasing utilization, and report those recommendations the Legislature. According to the BOE report:

"There are a number of options the Legislature may pursue that would have the potential to increase the amounts claimed subject to the partial exemption in the next calendar year that may result in actual amounts claimed being closer to estimated amounts. …These options include expanding the definition of useful life, increasing the amount of the annual cap, and expanding the definition of a qualified person."

SB 600 follows through on the directives of SB 90. It takes definitive action to expand our economy, to provide well-paying employment, and to generate a sustainable revenue source to fund our schools, roads and public services. It is our path to a more vibrant economy.

We, the employers and taxpayers of this state, respectfully call upon you to **SUPPORT** this legislation and partner with us to grow our California.

Sincerely,

California Taxpayers Association
Advanced Medical Technology Association
Air Logistics Corporation
Biocom
California Chamber of Commerce
Calaveras County Taxpayers Association
California Farm Bureau Federation
California League of Food Processors
California Life Sciences Association
California Manufacturers and Technology Association
Caterpillar
Computing Technology Industry Association
Council on State Taxation
Granite Construction
Intel Corporation
Kern County Taxpayers Association
National Federation of Independent Business
Orange County Business Council
Pacific Gas & Electric
Pasadena Chamber of Commerce
Plastics Industry Association
San Gabriel Valley Economic Partnership
Solano County Taxpayers Association
Solar Turbines
The Wonderful Company
Teichert Construction
Western Growers Association

Cc: The Honorable Cathleen Galgiani, California State Senate

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[i] Governor's May Revision 2013-14
[ii] State Board of Equalization Annual Report to the Legislature – Revenue and Taxation Code Section 6377.1
[iii] Tax Foundation Facts & Figures 2017: How Does Your State Compare?