

AMENDED IN ASSEMBLY APRIL 22, 2014

AMENDED IN ASSEMBLY APRIL 8, 2014

CALIFORNIA LEGISLATURE—2013–14 REGULAR SESSION

**ASSEMBLY BILL**

**No. 1564**

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**Introduced by Assembly Member V. Manuel Pérez**

January 29, 2014

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An act to add Article 4.5 (commencing with Section 12097) to Chapter 1.6 of Part 2 of Division 3 of Title 2 of the Government Code, and to amend Sections 17052.12 and 23609 of, and to add Section 19535 to, of the Revenue and Taxation Code, relating to taxation, and making an appropriation therefor.

LEGISLATIVE COUNSEL'S DIGEST

AB 1564, as amended, V. Manuel Pérez. Income taxes: research and development credit: credit sale and purchase.

The Personal Income Tax Law and the Corporation Tax Law allow various credits against the taxes imposed by those laws, including a credit for a percentage of specified research expenses.

This bill would increase that percentage by 3% each taxable year for 5 taxable years and then return to the current rate. This bill would create a Research and Development Tax Credit Trade Program, which the Governor's Office of Business and Economic Development (GO-Biz) Treasurer's office would administer to authorize taxpayers to purchase and sell the credits. *This bill would limit the total amount of credits sold to \$100 million per taxable year.* This bill would appropriate a portion of the money made from the sale of the credits to GO-Biz the Treasurer's office and the Franchise Tax Board for the costs incurred by the agencies in administering the program. ~~This bill would impose~~

~~specified auditing requirements on the Franchise Tax Board related to this credit, as specified.~~

Vote:  $\frac{2}{3}$ . Appropriation: yes. Fiscal committee: yes.  
State-mandated local program: no.

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

- 1 SECTION 1. The Legislature finds and declares the following:  
2 (a) California's greatest economic asset is its diverse economy  
3 that supports key industry clusters that rely upon innovation to  
4 compete globally.  
5 (b) California is uniquely situated to benefit from increasing  
6 research and development tax credits because of California's world  
7 renowned academic institutions, industry clusters, and diverse  
8 population that attracts worldwide talent.  
9 (c) Recent studies conducted by the Public Policy Institute of  
10 California ranked California fourth in the nation in entrepreneurial  
11 energy and second in the nation in innovation capacity. However,  
12 California was ranked as having only the 43rd most favorable  
13 corporate tax structure. This low ranking artificially reduces the  
14 capacity of research and development that could occur in the state  
15 because companies are more likely to expand to other states or  
16 countries where they will be taxed at a lower level.  
17 (d) Creating an environment rich in research and development  
18 spawns the growth of manufacturing. In the last 10 years, California  
19 has declined from the sixth largest economy in the world to the  
20 ninth, which is behind Brazil. During that time, manufacturing  
21 declined in California from 1.865 million jobs to 1.257 million  
22 jobs.  
23 (e) California needs to invest in the innovation economy by  
24 eliminating the roadblocks in state law and regulations and by  
25 developing a tax system that rewards capital expenditures in order  
26 to ensure that the private sector will invest financial capital and  
27 intellectual capital in California.  
28 (f) California needs to support the creation of new manufacturing  
29 jobs created by the private sector in the innovation economy with  
30 a highly skilled workforce.  
31 SEC. 2. It is the intent of the Legislature ~~to do the following:~~  
32 *incrementally increase the research and development tax credits*

1 *under the Personal Income Tax Law and the Corporation Tax Law*  
2 *up to 15 percent for a five-year period.*

3 ~~(a) Incrementally increase the research and development tax~~  
4 ~~credits under the Personal Income Tax Law and the Corporation~~  
5 ~~Tax Law up to 15 percent for a five-year period.~~

6 ~~(b) Create new and clearly defined auditing procedures for the~~  
7 ~~Franchise Tax Board relating to this credit to allow taxpayers~~  
8 ~~claiming a research and development tax credit to defend their~~  
9 ~~research and development activities.~~

10 SEC. 3. Article 4.5 (commencing with Section 12097) is added  
11 to Chapter 1.6 of Part 2 of Division 3 of Title 2 of the Government  
12 Code, to read:

13  
14 Article 4.5. The Research and Development Tax Credit Trade  
15 Program  
16

17 12097. ~~The Governor's Office of Business and Economic~~  
18 ~~Development (GO-Biz) Treasurer's office~~ shall develop and  
19 administer a program to allow the sale or purchase of research and  
20 development tax credits allowed under Sections 17052.12 and  
21 23609 of the Revenue and Taxation Code. ~~GO-Biz~~*The Treasurer's*  
22 *office* shall create an Internet Web site through which approved  
23 taxpayers may, by January 1, 2017, make such sale or purchase.

24 (a) The Franchise Tax Board shall notify ~~GO-Biz the~~  
25 *Treasurer's office* quarterly of all taxpayers that claim a credit  
26 under Sections 17052.12 and 23609 of the Revenue and Taxation  
27 Code, and the amount of credit claimed.

28 (b) A taxpayer may request approval by ~~GO-Biz the~~  
29 *Treasurer's office* to sell or purchase a credit.

30 (c) ~~GO-Biz~~*The Treasurer's office* shall approve a taxpayer  
31 before that taxpayer may sell or purchase the credits.

32 (1) ~~GO-Biz~~*The Treasurer's office* shall approve a taxpayer to  
33 sell its credits if that taxpayer has all of the following:

34 (A) A facility in which research and development occurs in the  
35 state.

36 (B) Less than fifty million dollars (\$50,000,000) in earnings  
37 before income tax, depreciation, and amortization.

38 (C) Unused research and development tax credits from a  
39 previous taxable year.

1 (D) A determination from the Franchise Tax Board that the  
2 credits to be sold are valid.

3 (2) ~~GO-Biz~~The Treasurer's office shall approve a taxpayer to  
4 purchase a research and development tax credit if all of the  
5 following requirements are met:

6 (A) The taxpayer has had qualified research expenses, as defined  
7 in Sections 17052.12 and 23609 of the Revenue and Taxation Code  
8 and Section 41 of the Internal Revenue Code, within the past five  
9 years.

10 (B) The taxpayer conducts a trade or business in the state.

11 (d) If a taxpayer is approved, ~~GO-Biz~~ the Treasurer's office  
12 shall create an online account for the taxpayer to allow the taxpayer  
13 to log into the Internet Web site to sell or purchase the credits.

14 (e) A taxpayer shall not be approved to sell or purchase more  
15 than five million dollars (\$5,000,000) in unused research and  
16 development tax credits per taxable year.

17 (f) If the taxpayer does not reinvest the money received from  
18 the sale of the credit into the taxpayer's trade or business or if the  
19 purchased credits reduce the taxpayer's tax liability by more than  
20 50 percent, any remaining unapplied credit shall be canceled and  
21 any previously applied credit that was not reinvested or that  
22 exceeds 50 percent of the taxpayer's tax liability shall be  
23 recaptured, and the taxpayer shall be liable for any increase in tax  
24 attributable to the recapture of any credit previously allowed under  
25 this section.

26 (g) The price of the credit shall be based on the open-market  
27 demand, *but shall not be less than 75 percent of the face value of*  
28 *the credit.*

29 (h) ~~GO-Biz~~The Treasurer's office shall notify the Franchise  
30 Tax Board of each sale or purchase of a credit, the identity of the  
31 taxpayer selling the credit, the identity of the taxpayer that  
32 purchased the credit, and the amount of the credit sold quarterly.  
33 The Franchise Tax Board shall review this information to ensure  
34 that a credit is not being used multiple times.

35 (i) *The total amount of the credits sold shall not exceed one*  
36 *hundred million dollars (\$100 million) per calendar year.*

37 12097.1. (a) There is hereby established in the State Treasury  
38 the Research and Development Tax Credit Trade Fund.

39 (b) (1) Until ~~GO-Biz~~ the Treasurer's office has been fully  
40 reimbursed for its costs of developing, creating, and starting the

1 Research and Development Tax Credit Trade Program, moneys  
2 in an amount equal to 15 percent of the face value of each credit  
3 sold or purchased on the Internet Web site established by ~~GO-Biz~~  
4 *the Treasurer's office* shall be deposited into the Research and  
5 Development Tax Credit Trade Fund for the purpose of funding  
6 this program pursuant to Section 12097, and appropriated as  
7 follows:

8 (A) Moneys in an amount equal to 13 percent of the face value  
9 of each credit to ~~GO-Biz~~ *the Treasurer's office* for the  
10 administrative and start-up costs of implementing this program.

11 (B) Moneys in an amount equal 2 percent of the face value of  
12 each credit to the Franchise Tax Board for the administrative costs  
13 of implementing this program.

14 (2) Eighty-five percent of the face value of each credit may be  
15 used as a credit against the "net tax" or "tax," as applicable of the  
16 taxpayer that purchased the credit.

17 (c) (1) Once ~~GO-Biz~~ *the Treasurer's office* has been fully  
18 reimbursed for its costs of developing, creating, and starting this  
19 program, moneys in an amount equal to 5 percent of the face value  
20 of each credit sold through the Internet Web site established by  
21 ~~GO-Biz~~ *the Treasurer's office* shall be deposited into the Research  
22 and Development Tax Credit Trade Fund for the purpose of funding  
23 the Research and Development Tax Credit Trade Program pursuant  
24 to Section 12097, and appropriated as follows:

25 (A) Moneys in an amount equal to 3 percent of the face value  
26 of each credit to ~~GO-Biz~~ *the Treasurer's office* for the  
27 administrative costs of implementing this program.

28 (B) Moneys in an amount equal to 2 percent of the face value  
29 of each credit to the Franchise Tax Board for the administrative  
30 costs of implementing this program.

31 (2) Ninety-five percent of the amount of each credit may be  
32 used as a credit against the "net tax" or "tax," as applicable of the  
33 taxpayer that purchased the credit.

34 SEC. 4. Section 17052.12 of the Revenue and Taxation Code  
35 is amended to read:

36 17052.12. For each taxable year beginning on or after January  
37 1, 1987, there shall be allowed as a credit against the "net tax" (as  
38 defined by Section 17039) for the taxable year an amount  
39 determined in accordance with Section 41 of the Internal Revenue  
40 Code, except as follows:

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

4 (b) (1) For each taxable year beginning on or after January 1,  
5 1997, and before January 1, 1999, the reference to “20 percent”  
6 in Section 41(a)(1) of the Internal Revenue Code is modified to  
7 read “11 percent.”

8 (2) For each taxable year beginning on or after January 1, 1999,  
9 and before January 1, 2000, the reference to “20 percent” in Section  
10 41(a)(1) of the Internal Revenue Code is modified to read “12  
11 percent.”

12 (3) For each taxable year beginning on or after January 1, 2000,  
13 and before January 1, 2014, the reference to “20 percent” in Section  
14 41(a)(1) of the Internal Revenue Code is modified to read “15  
15 percent.”

16 (4) For each taxable year beginning on or after January 1, 2014,  
17 and before January 1, 2015, the reference to “20 percent” in Section  
18 41(a)(1) of the Internal Revenue Code is modified to read “18  
19 percent.”

20 (5) For each taxable year beginning on or after January 1, 2015,  
21 and before January 1, 2016, the reference to “20 percent” in Section  
22 41(a)(1) of the Internal Revenue Code is modified to read “21  
23 percent.”

24 (6) For each taxable year beginning on or after January 1, 2016,  
25 and before January 1, 2017, the reference to “20 percent” in Section  
26 41(a)(1) of the Internal Revenue Code is modified to read “24  
27 percent.”

28 (7) For each taxable year beginning on or after January 1, 2017,  
29 and before January 1, 2018, the reference to “20 percent” in Section  
30 41(a)(1) of the Internal Revenue Code is modified to read “27  
31 percent.”

32 (8) For each taxable year beginning on or after January 1, 2018,  
33 and before January 1, 2019, the reference to “20 percent” in Section  
34 41(a)(1) of the Internal Revenue Code is modified to read “30  
35 percent.”

36 (9) For each taxable year beginning on or after January 1, 2019,  
37 the reference to “20 percent” in Section 41(a)(1) of the Internal  
38 Revenue Code is modified to read “15 percent.”

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

1 (d) “Qualified research” shall include only research conducted  
2 in California.

3 (e) In the case where the credit allowed under this section  
4 exceeds the “net tax,” the excess may be carried over to reduce  
5 the “net tax” in the following year, and succeeding years if  
6 necessary, until the credit has been exhausted.

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

13 (2) For each taxable year beginning on or after January 1, 1998,  
14 the reference to “Section 501(a)” in Section 41(b)(3)(C) of the  
15 Internal Revenue Code, relating to contract research expenses, is  
16 modified to read “this part or Part 11 (commencing with Section  
17 23001).”

18 (g) (1) For each taxable year beginning on or after January 1,  
19 2000:

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

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

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

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

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

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

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

5 (i) Section 41(g) of the Internal Revenue Code, relating to  
 6 special rule for passthrough of credit, is modified by each of the  
 7 following:

8 (1) The last sentence shall not apply.

9 (2) If the amount determined under Section 41(a) of the Internal  
 10 Revenue Code for any taxable year exceeds the limitation of  
 11 Section 41(g) of the Internal Revenue Code, that amount may be  
 12 carried over to other taxable years under the rules of subdivision  
 13 (e); except that the limitation of Section 41(g) of the Internal  
 14 Revenue Code shall be taken into account in each subsequent  
 15 taxable year.

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

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

20 (l) Section 41(f)(6), relating to energy research consortium,  
 21 shall not apply.

22 (m) A taxpayer may sell a credit allowed under this section  
 23 pursuant to Article 4.5 (commencing with Section 12097) of  
 24 Chapter 1.6 of Part 2 of Division 3 of Title 2 of the Government  
 25 Code.

26 ~~SEC. 5.—Section 19535 is added to the Revenue and Taxation~~  
 27 ~~Code, to read:~~

28 ~~19535.—(a) The Franchise Tax Board shall perform the~~  
 29 ~~following audit procedures if a taxpayer filed for a credit under~~  
 30 ~~Section 17052.12 or 23609 and was not allowed that credit:~~

31 ~~(1) Use a risk-based approach to conduct an audit. The~~  
 32 ~~risk-based approach shall focus on identifying areas of a taxpayer’s~~  
 33 ~~business or trade in which there may be subjectivity in determining~~  
 34 ~~whether an employee of the taxpayer is performing qualified~~  
 35 ~~research or nonqualified research, and what percentage of that~~  
 36 ~~employee’s time is devoted to performing qualified research.~~

37 ~~(2) Require a general explanation of the taxpayer’s trade or~~  
 38 ~~business, the role of research and development in the trade or~~  
 39 ~~business, the development of new and improved products,~~  
 40 ~~processes, and software from the taxpayer.~~

1 ~~(3) Determine whether the Internal Revenue Service has~~  
2 ~~conducted an examination of the credit allowed under Section 41~~  
3 ~~of the Internal Revenue Code and request a copy of the audit report.~~  
4 ~~If the Internal Revenue Service has conducted an examination, the~~  
5 ~~Franchise Tax Board shall rely upon the findings of the~~  
6 ~~examination, subject to verifying that the research activities and~~  
7 ~~costs were incurred in state.~~

8 ~~(4) Conduct a physical tour of the taxpayer's facilities and~~  
9 ~~interview employees of the taxpayer that are performing qualified~~  
10 ~~research. A physical tour should be conducted prior to arriving at~~  
11 ~~a determination that a taxpayer's activities do not qualify as~~  
12 ~~qualified research, as defined in Sections 17052.12 and 23609.~~  
13 ~~The tour shall include the area in which research is performed and~~  
14 ~~follow a product or process through its life cycle beginning with~~  
15 ~~development and ending in production.~~

16 ~~(5) Identify the types of employees dedicated to research,~~  
17 ~~production, or administrative duties, or a mixture of any of those~~  
18 ~~activities.~~

19 ~~(b) The Franchise Tax Board may perform the following audit~~  
20 ~~procedures if a taxpayer filed for a credit under Section 17052.12~~  
21 ~~or 23609 and was not allowed that credit and the auditor deems it~~  
22 ~~necessary:~~

23 ~~(1) Ask the taxpayer to provide examples of research projects~~  
24 ~~from the examination years and to describe projects that are~~  
25 ~~currently under development.~~

26 ~~(2) Ask the taxpayer to explain each step of the development~~  
27 ~~process, where mixed-services are performed, and distinguish~~  
28 ~~between production or administration functions and research.~~

29 ~~(c) If the Franchise Tax Board determines a particular expense~~  
30 ~~to not be a qualified research expenditure, a taxpayer shall be~~  
31 ~~allowed an opportunity to provide additional supporting records.~~  
32 ~~If an adjustment in whether an expense is considered a qualified~~  
33 ~~research expense is necessary based on the taxpayer's additional~~  
34 ~~supporting records, the Franchise Tax Board shall explain and~~  
35 ~~document the discrepancy. An adjustment based upon mere~~  
36 ~~criticism of a taxpayer's workpapers, study, methods, or vague~~  
37 ~~disallowance for law of substantiation, without actual information~~  
38 ~~or evidence that contradict a taxpayer's documents or other~~  
39 ~~evidence shall not be upheld. A lack of substantiation shall be a~~

1 ~~valid reason for disallowing a credit when the taxpayer only~~  
 2 ~~submits vague testimony.~~

3 ~~SEC. 6.~~

4 *SEC. 5.* Section 23609 of the Revenue and Taxation Code is  
 5 amended to read:

6 23609. For each taxable year beginning on or after January 1,  
 7 1987, there shall be allowed as a credit against the “tax” (as defined  
 8 by Section 23036) an amount determined in accordance with  
 9 Section 41 of the Internal Revenue Code, except as follows:

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

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

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

16 (b) (1) For each taxable year beginning on or after January 1,  
 17 1997, and before January 1, 1999, both of the following  
 18 modifications shall apply:

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

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

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

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

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

29 (3) For each taxable year beginning on or after January 1, 2000,  
 30 and before January 1, 2014, both of the following shall apply:

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

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

35 (4) For each taxable year beginning on or after January 1, 2014,  
 36 and before January 1, 2015, both of the following shall apply:

37 (A) The reference to “20 percent” in Section 41(a)(1) of the  
 38 Internal Revenue Code is modified to read “18 percent.”

39 (B) The reference to “20 percent” in Section 41(a)(2) of the  
 40 Internal Revenue Code is modified to read “27 percent.”

- 1 (5) For each taxable year beginning on or after January 1, 2015,  
2 and before January 1, 2016, both of the following shall apply:  
3 (A) The reference to “20 percent” in Section 41(a)(1) of the  
4 Internal Revenue Code is modified to read “21 percent.”  
5 (B) The reference to “20 percent” in Section 41(a)(2) of the  
6 Internal Revenue Code is modified to read “30 percent.”  
7 (6) For each taxable year beginning on or after January 1, 2016,  
8 and before January 1, 2017, both of the following shall apply:  
9 (A) The reference to “20 percent” in Section 41(a)(1) of the  
10 Internal Revenue Code is modified to read “24 percent.”  
11 (B) The reference to “20 percent” in Section 41(a)(2) of the  
12 Internal Revenue Code is modified to read “33 percent.”  
13 (7) For each taxable year beginning on or after January 1, 2017,  
14 and before January 1, 2018, both of the following shall apply:  
15 (A) The reference to “20 percent” in Section 41(a)(1) of the  
16 Internal Revenue Code is modified to read “27 percent.”  
17 (B) The reference to “20 percent” in Section 41(a)(2) of the  
18 Internal Revenue Code is modified to read “36 percent.”  
19 (8) For each taxable year beginning on or after January 1, 2018,  
20 and before January 1, 2019, both of the following shall apply:  
21 (A) The reference to “20 percent” in Section 41(a)(1) of the  
22 Internal Revenue Code is modified to read “30 percent.”  
23 (B) The reference to “20 percent” in Section 41(a)(2) of the  
24 Internal Revenue Code is modified to read “39 percent.”  
25 (9) For each taxable year beginning on or after January 1, 2019,  
26 both of the following shall apply:  
27 (A) The reference to “20 percent” in Section 41(a)(1) of the  
28 Internal Revenue Code is modified to read “15 percent.”  
29 (B) The reference to “20 percent” in Section 41(a)(2) of the  
30 Internal Revenue Code is modified to read “24 percent.”  
31 (c) (1) With respect to any expense paid or incurred after the  
32 operative date of Section 6378, Section 41(b)(1) of the Internal  
33 Revenue Code is modified to exclude from the definition of  
34 “qualified research expense” any amount paid or incurred for  
35 tangible personal property that is eligible for the exemption from  
36 sales or use tax provided by Section 6378.  
37 (2) “Qualified research” and “basic research” shall include only  
38 research conducted in California.  
39 (d) The provisions of Section 41(e)(7)(A) of the Internal  
40 Revenue Code, shall be modified so that “basic research,” for

1 purposes of this section, includes any basic or applied research  
2 including scientific inquiry or original investigation for the  
3 advancement of scientific or engineering knowledge or the  
4 improved effectiveness of commercial products, except that the  
5 term does not include any of the following:

- 6 (1) Basic research conducted outside California.
- 7 (2) Basic research in the social sciences, arts, or humanities.
- 8 (3) Basic research for the purpose of improving a commercial  
9 product if the improvements relate to style, taste, cosmetic, or  
10 seasonal design factors.
- 11 (4) Any expenditure paid or incurred for the purpose of  
12 ascertaining the existence, location, extent, or quality of any deposit  
13 of ore or other mineral (including oil and gas).

14 (e) (1) In the case of a taxpayer engaged in any  
15 biopharmaceutical research activities that are described in codes  
16 2833 to 2836, inclusive, or any research activities that are described  
17 in codes 3826, 3829, or 3841 to 3845, inclusive, of the Standard  
18 Industrial Classification (SIC) Manual published by the United  
19 States Office of Management and Budget, 1987 edition, or any  
20 other biotechnology research and development activities, the  
21 provisions of Section 41(e)(6) of the Internal Revenue Code shall  
22 be modified to include both of the following:

23 (A) A qualified organization as described in Section  
24 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an  
25 institution of higher education as described in Section 3304(f) of  
26 the Internal Revenue Code.

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

33 (2) For purposes of this subdivision:

34 (A) “Biopharmaceutical research activities” means those  
35 activities that use organisms or materials derived from organisms,  
36 and their cellular, subcellular, or molecular components, in order  
37 to provide pharmaceutical products for human or animal  
38 therapeutics and diagnostics. Biopharmaceutical activities make  
39 use of living organisms to make commercial products, as opposed

1 to pharmaceutical activities that make use of chemical compounds  
2 to produce commercial products.

3 (B) “Other biotechnology research and development activities”  
4 means research and development activities consisting of the  
5 application of recombinant DNA technology to produce  
6 commercial products, as well as research and development  
7 activities regarding pharmaceutical delivery systems designed to  
8 provide a measure of control over the rate, duration, and site of  
9 pharmaceutical delivery.

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

14 (g) For each taxable year beginning on or after January 1, 1998,  
15 the reference to “Section 501(a)” in Section 41(b)(3)(C) of the  
16 Internal Revenue Code, relating to contract research expenses, is  
17 modified to read “this part or Part 10 (commencing with Section  
18 17001).”

19 (h) (1) For each taxable year beginning on or after January 1,  
20 2000:

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

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

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

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

36 (3) Section 41(c)(7) of the Internal Revenue Code, relating to  
37 gross receipts, is modified to take into account only those gross  
38 receipts from the sale of property held primarily for sale to  
39 customers in the ordinary course of the taxpayer’s trade or business

1 that is delivered or shipped to a purchaser within this state,  
2 regardless of f.o.b. point or any other condition of the sale.

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

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

7 (j) Section 41(g) of the Internal Revenue Code, relating to  
8 special rule for passthrough of credit, is modified by each of the  
9 following:

10 (1) The last sentence shall not apply.

11 (2) If the amount determined under Section 41(a) of the Internal  
12 Revenue Code for any taxable year exceeds the limitation of  
13 Section 41(g) of the Internal Revenue Code, that amount may be  
14 carried over to other taxable years under the rules of subdivision  
15 (f), except that the limitation of Section 41(g) of the Internal  
16 Revenue Code shall be taken into account in each subsequent  
17 taxable year.

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

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

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

25 (n) A taxpayer may sell a credit allowed under this section  
26 pursuant to Article 4.5 (commencing with Section 12097) of  
27 Chapter 1.6 of Part 2 of Division 3 of Title 2 of the Government  
28 Code.