

January 24, 2005

The Honorable John Chiang, Member  
The Honorable Bill Leonard, Member  
The Honorable Claude Parrish, Member  
The Honorable Betty T. Yee, Member  
The Honorable Steve Westly, Member Ex Officio  
Board of Equalization  
State of California  
450 N Street  
Sacramento, CA 95814

Re: Tax Refunds to Companies That Have Paid No Income Taxes

Dear Members of the Board of Equalization:

Tomorrow you will vote on whether to send eighteen manufacturers an estimated \$77 million in income tax refund checks even though these corporations have paid no income taxes in California. State law expressly prohibits such refunds, and authorization would constitute an illegal waste of taxpayer funds at a time when the People of California can hardly afford such an undeserved and improper giveaway of taxpayer money. We write to urge you to reject the applications of these powerful special interests and to reverse your prior decisions, made with little public scrutiny several weeks ago, to authorize approximately \$5 million in refunds for three other companies – Conextant Systems, Grundfos U.S. Holding Company, and Lightwave Electronics corporation -- that also paid no taxes.

Each of the companies that have applied for refunds – LSI Logic, Cypress Semiconductor, Sun Microsystems, Symbol Technologies, Exar, LAM Research, KLA-Tencor, Rockwell Automation, National Semiconductor, Advanced Cardiovascular Systems, Adaptec, Powerwave Technologies, ESS Technology, Beckman Coulter, Hewlett-Packard, Integrated Device Technology, Intel, and Level One Communications – are claiming the money under Revenue and Tax Code section §6902.2, an amendment to the Manufacturer's Investment Credit. This tax credit was established in 1993 in order to encourage investment in manufacturing, and 6902.2 was added in 1994. (The MIC expired in 2003 because it failed to reach its stated objective of creating 100,000 additional manufacturing jobs over that period).

Section 6902.2, as added by SB 1811 in 1994, authorizes investment tax credits only as offsets to income taxes, in other words, the credit is only applicable to reduce a corporation's positive tax liability (and then only for certain taxes). It was referred to as a "technical measure" in the Senate Floor analysis, and because the refund could be no more than the amount of credit otherwise allowed, SB 1811 was determined to have no fiscal impact upon the state.

Indeed, until the current Board decided peremptorily to reinterpret the law, companies without income tax liability did as the law provided—they carried forward their unused credits into subsequent years. Now, based on an untenable interpretation of the statute, each of the companies now seeks a cash refund, despite the fact that they paid no income tax for the year in which they claim the credit.

Section 6902.2 explicitly bars refunds in such circumstances, as the professional staff of the Board and other independent experts have repeatedly advised you.<sup>1</sup> (*See, for example, Department's Reply to Claimant's Opening Brief, In the Matter of the Claim for Refund of LSI Logic under the Sales and Use Tax Law.*) Despite the express provisions of the statute, however, the Board in 2003 authorized refunds to two corporations that had paid no income taxes, LSI Logic and Cypress Semiconductor. In response to that giveaway of public funds, the Legislature enacted SB 1064 (sponsored by Senate President Pro Tem John Burton), which reiterates that under § 6902.2, the Manufacturer's Investment Credit is intended only to offset other income and cannot be used to generate a tax refund. Additionally, SB 1064 authorized the Board to "recover any refund...that is erroneously made pursuant to this section."

Despite this unmistakable legislative directive, lobbyists for the corporations, including PricewaterhouseCoopers, now argue that SB 1064 changed the law and that the prohibition on MIC refunds operates only for applications filed after August 7, 2003. They rely on the statement that "The amendments [in SB 1064]... are effective for any claims for refund filed with the State Board of Equalization on or after August 7, 2003." Their argument has no merit. Section 2 of SB 1064 states that its amendments are "declaratory of existing law." The amendment's reference to applications filed after August 7, 2003 is intended to allow the Board of Equalization to continue to consider claims filed before the bill became law, but clarifies that such refunds have *never* been permitted by law.

Your approval of the requested refunds would be an unlawful waste of public monies.

It is difficult for taxpayers to fathom how their public officials could even contemplate such an action, particularly given the enormous budget deficit our state faces. At a time when Californians are being asked to make deep sacrifices,

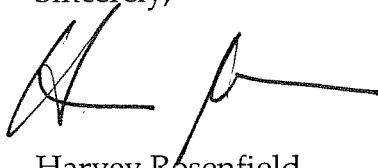
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<sup>1</sup> Indeed, the Legislature has rejected legislation (SB 1045 in 1997; AB 1976 in 1998) which would have made the credit refundable.

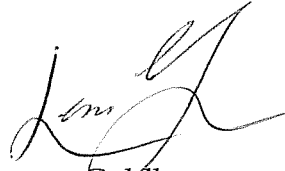
when the Governor proposes to slash funding for schools, health care and other programs in order to address a mushrooming deficit, Californians cannot afford to bestow upon a few dozen politically connected corporations a multi-million dollar gift of taxpayers' hard-earned money. The fact that these enormous corporations – some of the largest in California – paid no income taxes for at least one year strongly supports our view that there is no reason for each of you to further coddle California's corporate welfare queens.

We urge you to reject the applications of these powerful special interests and to use the authority provided to the Board by the Legislature to recover the MIC refunds improperly bestowed previously.

Sincerely,



Harvey Rosenfield  
The Foundation for Taxpayer and  
Consumer Rights  
1750 Ocean Park Bl., Suite 200  
Santa Monica, CA 90405  
(310) 392-0522



Lenny Goldberg  
California Tax Reform Association  
926 J Street, Suite 710  
Sacramento, CA 95814  
(916) 446-4300