

# Cal-Tax Digest

A PUBLICATION OF THE CALIFORNIA TAXPAYERS' ASSOCIATION

**Spring 2003**[Table of Contents](#)[Cal-Tax Home](#)[Email Editor](#)**GUEST COMMENTARY**

## Keep and Enhance the Manufacturers Investment Credit

*By Ray Rossi*



*Ray Rossi is director, external tax affairs for the Intel Corporation.*

*(Ray Rossi, director of external tax affairs for Intel Corporation, testified on the impact of California's manufacturers investment credit before the Assembly Committee on Revenue and Taxation. This article is based on his February 3, 2003 testimony.)*

Nearly a decade ago, as California was struggling to recover from a severe recession, the economic recovery package approved by the Legislature worked. And it featured the manufacturers investment credit (MIC).

As eventually approved, the MIC provides a 6 percent tax credit on costs of qualifying manufacturing equipment. Now, as continuation of the MIC has come under assault from those who lobby for bigger government, these experiences should not be ignored:

The MIC has been instrumental in Intel's growth of both its manufacturing and research presence in California, and the jobs that depend upon that continuing, and growing presence.

Taxes matter a great deal in the site-selection process used by Intel because they are easily measured and compared with the taxes that would be levied by another state or country seeking job-producing industry.

The MIC is needed now more than ever to help retain this state's current level of competitiveness for additional manufacturing and research investments. Its demise would be not only untimely, but also unwarranted. Instead, policy-makers should be looking for ways to enhance the existing MIC.

To understand the crucial role the MIC plays in the California economy, it is useful to revisit those dark days of the early 1990s.

Prior to the 1993 passage of the MIC, Dr. Gordon Moore, a founder and then-chairman of Intel, accompanied me to Sacramento to urge approval of a sales tax exemption for manufacturing and research equipment, and facilities of California manufacturers. This was in light of Intel's ongoing site selection process.

Gordon was well aware of, and cited, the adverse difference in comparing California, at that time the site of an Intel fabrication facility, with other jurisdictions. For example, Arizona already had the desired sales tax exemption that was an \$80-million difference, an advantage for Arizona based on the assumed cost of at least \$1 billion for a wafer fabrication facility (the cost of such a facility now has grown to \$2.5 billion or more, given new technology and building needs). Arizona was at that time the location of certain Intel operations, including fabrication, and also the location of those of one of our major competitors at that time, Motorola. Also of note, Oregon, another location of Intel fab facilities, had no sales tax at all, and continues to have no sales tax.

Legislators asked whether this difference would mean that Intel would no longer invest in a new or expanded fabrication facility (fab) in California, absent passage of the sales tax exemption. Not necessarily, Gordon replied, but he added that he would need to provide a very good explanation to his board of directors, his employees, his shareholders, his customers, and other interested parties. They would want to know why the company would ignore an \$80 million cost savings.

**The reality of company investment decisions is that taxes do matter, and after several possible locations have been identified in which Intel can successfully operate, taxes matter a great deal.**

With few relatively simple assumptions, the potential tax cost of various sites can be easily quantified in the 10-year comparative operating cost model used by Intel to make capital investment decisions. Certain other criteria taken into account, like the quality of the education system, are not as easily quantified nor as visible as a relative difference in the model.

Currently, at least seven other such qualified fab operating locations have been identified, because Intel already successfully operates fabs there: Arizona, New Mexico, Oregon, Massachusetts, Colorado, Israel, and Ireland. Of note is the relative larger investment aid provided by foreign locations – for example, in the case of Israel, the government contributed roughly two-thirds of the cost of Intel's first fab built there some years ago. In addition, Intel is often approached by yet other new potential locations, urging us to consider their attractiveness as fab sites. That attractiveness is considerable. One such example: Florida has an investment credit that provides 5 percent per year of the original cost for a 20-year period.

In this context, when asked whether Intel would invest in manufacturing and research productive assets in any event, I have answered “yes” in the past. We will continue to invest in such assets because our business depends greatly on the state-of-the-art facilities and technology. However, that is the wrong question – the right one is not whether we will invest, but where.

It is also important to note, given the rapid pace of technologic change and developments, there is a need for frequent new rounds of capital investment in existing facilities to retain their relevance to the marketplace. These capital additions are ongoing, but also entail even more substantial periodic expenditures to retrofit. Otherwise, a fab, in a relatively short period of less than five years, may become the “dinosaur” of the family of facilities, and be at risk of closure.

Ultimately, the California legislature passed the 6 percent MIC, rather than the desired sales tax exemption. The MIC provided a profitable company, such as Intel, a \$60 million savings, rather than \$80 million, on the \$1 billion fab discussed above.

### **Post-MIC**

Although Gordon Moore’s response, mentioned above, was appropriate and accurate, after the MIC passed, **Intel’s actions indeed spoke louder than Gordon’s words: the MIC enabled a torrent of new capital investment in California.** Within a year of the MIC’s passage, a \$700 million investment in the fab facility in Santa Clara was announced. Also, a building under construction in Folsom, to house research operations, was doubled in size to be a four-story facility instead of two. Subsequently, in Santa Clara, a further periodic new capital investment in excess of \$500 million was made in the 1998-99 time frame. Coupled with ongoing investments in the Santa Clara facility, these post-MIC investments added in total about \$1.7 billion. In addition, a new mask-design facility at another Santa Clara site required another \$230 million investment. In Folsom, two more four-story buildings have been added, and all post-MIC investments there total about \$800 million. More important than the added invested dollars, they have also enabled the Santa Clara and Folsom sites to retain their vitality and currency of technology, and have made Intel’s presence in California second only in headcount to its presence in Oregon – this is among not only U.S. sites, but worldwide. Current employment is about 14,500, compared to about 14,600 in Oregon.

The crucial role of the MIC can better be understood when it is also known that, of the Intel fab sites in the United States and worldwide, California has the highest operating cost per wafer. Utilizing the same process and technology, and after eliminating any extraordinary start-up and/or phase-down costs, the

California cost per wafer is two and a half times the lowest cost location, and 33 percent higher than the next highest cost site.

It is important to note the key symbolic and economic role that has also been played by the California R&D Tax Credit, a permanent 15 percent credit applicable to research labor and materials (but not machinery and equipment). It complements the MIC, and ranks among the best research credits in the country.

It is also important to note that although the MIC has allowed Intel to retain and grow manufacturing and research jobs in California, only direct manufacturing jobs would be counted toward the required 100,000 jobs threshold first applicable on January 1, 2001, and then each year thereafter. (The MIC can be automatically repealed on January 1, 2004 if the Employment Development Department determines that new manufacturing jobs have fallen below the threshold of 100,000.)

### **The Current Situation**

The semiconductor industry, as are many others, is in the midst of a prolonged downturn. The post dot-com, post-9/11 economic challenges have combined to create an unprecedented economic multi-year recession. The recent Joint Venture: Silicon Valley Network 2003 Index cites a finding that, relative to the rest of the nation, Silicon Valley is losing its concentration of employment in all reported areas, except biotech. This includes a substantial decline in both semiconductor and semiconductor equipment manufacturing employment concentration.

Of note is the recent Intel announcement of its expected capital spending for 2003 – it is anticipated to be around \$3.7 billion, one billion less than 2002 spending and about three billion less than spending two years ago. No longer can I answer the “whether” question, discussed above, with the answer given in the past. **Unlike the past, where capital spending virtually consistently increased as a matter of course and “where” was the relevant question, this is no longer true. The MIC is now essential also to leverage increasingly hard-to-find capital dollars to a greater extent.**

The fact that the 100,000 increase in manufacturing jobs is now in jeopardy of being lost is indicative of numerous cost pressures which emerged disproportionately in California. Subsequent to the last downturn from which the MIC emanated, there have been substantial increases in energy and workers’ compensation insurance costs. Also, the strength and length of the current downturn are unprecedented for California manufacturers, especially high-tech.

**The MIC has a strong correlation to job creation and retention.** Under more predictable circumstances contemplated when the MIC was passed, during the interim period of 1994 through 2000, the decline in manufacturing jobs was

reversed. The 100,000 jobs threshold was exceeded by at least another 100,000. Notable is the similarity of the percentage of jobs in the high-tech manufacturing sector. As cited in a recent Milken Institute study, entitled *The Economic Impact of a Sales Tax Reduction on Manufacturing Equipment*, almost 40 percent of the state's manufacturing jobs, and the percentage of slightly over 40 percent of MIC claims involve high-tech computer and electronic equipment manufacturers, as reported by the Legislative Analyst's Office MIC Study.

Cost differentials of California versus other manufacturing locations continue to grow (especially compared to offshore locations, including China). Importantly, numerous other states currently offer not only investment credits, but also sales tax exemptions on manufacturing and/or research equipment.

**Clearly, the demise of the MIC would be a tremendous blow to California's ability to compete for manufacturing jobs.** Over two-thirds of the states provide sales tax exemptions for manufacturing assets, and over one-quarter of them have such exemptions for research assets. Over three-quarters of the states have investment tax credits of varying types, and almost half have both credits and sales tax exemptions applicable to manufacturing assets. In contrast, California has only the 6 percent MIC investment tax credit, equal to about three-quarters of a sales tax exemption.

The current California sales tax exemption is confined to start-up companies, or those who could claim the MIC but instead choose to claim the sales tax exemption. In any event, California is not competitive with those states, including several major industrial ones, that currently offer both an investment credit and a sales tax exemption. In California, it is one or the other.

The MIC, when enacted, was applicable in the first year thereafter, but the MIC claim for that year was delayed until the following year – a similar way of delaying the revenue impact to the state, but gaining the stimulus effect immediately (save for the time value of money). This technique could be utilized to enhance, not just maintain, the MIC.

**Now is not the time for the MIC to be left to expire – rather it should offer an opportunity for renewal, and if possible, enhancement, including a complementary sales tax exemption.**

It is important to note that the many (non-start-up) companies currently experiencing losses cannot benefit from the MIC, but could through a sales tax exemption. In addition, research capital investments are ever more critical by not only those also manufacturers, but in general. Intel's management has stated frequently that new technology is critical to help speed and sustain an economic recovery. A complementary sales tax exemption and/or the MIC (if a reenactment opportunity occurs or is necessitated) could stimulate greater research capital investments by extending these provisions to all research asset

investments, not just those of manufacturers. As stated above, the research credit applies only to labor and materials, not capital assets, and has no impact with respect to such research capital investments.

It must be noted that the 100,000-jobs threshold was at the time of passage of the MIC the preferred choice between it and a “sunset” in a fixed period of years. That possibility is once again being discussed as a “structural reform” for California’s tax system. In reality, sunsets are inherently counter-productive to sound business decision-making, which must accord with and be based upon known and reliable, certain information. A sunset would cheat the MIC and all other similar provisions (including the current permanent research credit) of having the maximum impact intended by the Legislature. As discussed above, business location/reinvestment/expansion decisions are made on projected operating costs over a period of years. If a sunset interrupts the analysis period, the beneficial cost effect of the tax provision will not be taken into account as a positive factor in the decision-making process – it cannot, as the continuation of the favorable provision is not a reliable fact, it is at best a hopeful assumption.

**The MIC produced a reversal of manufacturing job losses in the early nineties, and restored job growth to the manufacturing sector. It should be allowed to continue in order to do the same again, especially given the serious and unprecedented challenges now facing California’s manufacturers.**