
SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair
2025 - 2026 Regular

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Author:	McNerney	Tax Levy:	No
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PERSONAL INCOME TAX LAW: CORPORATION TAX LAW: CREDITS: CALCOMPETES

Extends the allocation authority for the California Competes Tax Credit for five years, and allows applicants in strategic industries to elect for credits to be refundable.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something they would otherwise not do, but for the tax credit. The Department of Finance is required to annually publish a list of tax expenditures, which currently total around \$94.2 billion per year.

Refundable tax credits. Generally, California's tax credits for business entities are nonrefundable, meaning that taxpayers can apply credits to reduce their tax liability in the current taxable year, and carry forward any remainder to subsequent taxable years. The number of subsequent years – known as the carry forward period – varies among credits. Taxpayers can also assign credits to other corporations within its combined group (AB 1452, Committee on Budget, 2008).

The Legislature has added other mechanisms to two of the state's credits – the Low-Income Housing Tax Credit (LIHTC) and the Television and Motion Picture Production Credit – to enhance taxpayers' ability to fully utilize the value of each credit. Applicants awarded LIHTCs may sell them to unrelated taxpayers; taxpayers awarded Television and Motion Picture Production Credits can also claim refunds if the credits are attributable to an independent film. Additionally, any taxpayer that generates Television and Motion Picture Production Credits can elect to apply credits to offset any sales and use tax liability, and obtain either a refund of a portion of previously paid sales and use taxes or an offset of future ones. The Television and Motion Picture Production Credits also include boutique credit-sharing provisions that are more flexible than those that apply to other corporations under AB 1452.

In 2023, the Legislature enacted SB 132 (Committee on Budget & Fiscal Review), which, among other provisions, makes the Television and Motion Picture Production Credits California's first refundable business entity tax credit, which allows firms with no income or sales tax liability to receive a cash refund from the state. Up to that point, the state's only refundable credits were for individuals, namely the Earned Income, Young Child, and Foster Youth Tax Credits, as Franchise Tax Board (FTB) information technology systems could not easily administer

refundable business credits. The 2023-24 Budget Act included General Fund appropriations of \$4.5 million in 2023-24, \$1 million in 2024-25, and \$753,000 in 2025-26 and ongoing for FTB to hire personnel and expand the tax systems necessary to support refundable credits for business entities.

In 2024, the Legislature limited the total of all business credits, with some exceptions, including credit carry forwards, to \$5,000,000, in the 2024, 2025, and 2026 taxable years, unless the Director of Finance determines that General Fund money over the multiyear forecast is sufficient without the revenue impact of the net operating loss suspension and credit limitation (SB 167 and SB 175, Committee on Budget & Fiscal Review). Taxpayers can make an irrevocable election to receive an annual refundable credit in future tax years for business credits disallowed due to the limitation.

California Competes. In 2013, the Legislature enacted AB 93 (Committee on Budget) and SB 90 (Committee on Budget & Fiscal Review), measures that reformed California's economic development policies by eliminating enterprise zones and other geographically-targeted economic development areas, instead allowing three new tax benefits. Among them was the California Competes Tax Credit. The California Competes Tax Credit Committee, which was also created by the bill, awards various tax credits up to an annually capped amount to taxpayers who apply. The credit is available to businesses in any industry.

The Committee is comprised of the Treasurer, the Director of Finance, the Director of the Governor's Office of Business and Economic Development (GO-Biz), one appointee of the Speaker of the Assembly, and one appointee from the Senate Committee on Rules. In 2018, the Legislature enacted SB 855 (Committee on Budget & Fiscal Review), which extended the Committee's authority to allocate \$180 million in credits each year through the 2022-23 fiscal year.

Under California Competes, the Committee awards tax credits to successful applicants in specified amounts, pursuant to written agreements, after a competitive application process. This model differs from typical tax credits, where any taxpayer engaging in a specifically defined activity or incurring certain costs during the taxable year can automatically claim the credit. State law directs the Committee to allocate credits to taxpayers as part of a written agreement, based on the following factors:

- The number of jobs the taxpayer will create or retain in this state.
- The compensation paid or proposed to be paid by the taxpayer to its employees, including wages and fringe benefits.
- The amount of investment in this state by the taxpayer.
- The extent of unemployment or poverty in the area, according to the United States Census Bureau, in which the taxpayer's project or business is proposed or located.
- The incentives available to the taxpayer in this state, including incentives from the state, local government, and other entities.
- The incentives available to the taxpayer in other states.
- The duration of the proposed project and the duration the taxpayer commits to remaining in this state.
- The overall economic impact in this state of the taxpayer's project or business.
- The strategic importance of the taxpayer's project or business to the state, region, or locality.

- The opportunity for future growth and expansion in this state by the taxpayer's business.
- The extent to which the anticipated benefit to the state exceeds the projected benefit to the taxpayer from the tax credit.
- Training opportunities offered by the taxpayer to its employees.

State law also contains the following permissive criteria for the Committee to consider when determining whether to enter into an agreement with the taxpayer:

- The financial solvency of the taxpayer and the taxpayer's ability to finance its proposed expansion.
- The taxpayer's current and prior compliance with federal and state laws.
- Current and prior litigation involving the taxpayer.
- The reasonableness of the fee arrangement between the taxpayer and any third party providing any services related to the credit allowed pursuant to this section.
- Any other factors GO-Biz deems necessary to ensure that the administration of the credit is a model of accountability and transparency and that the effective use of the limited amount of credit available is maximized.

SB 855 required the Committee to consider the extent to which the credit will influence the taxpayer's ability, willingness, or both, to create jobs in this state that the taxpayer or any other taxpayer might not otherwise create. SB 855 also directed the Committee to consider the taxpayer's training opportunities for its employees when determining whether to enter into an agreement to allocate credits. The Legislative Analyst's Office (LAO) reported that following SB 855's changes, "California Competes appears to be better targeted at awarding credits to businesses more likely to create a net increase in jobs. We also observed that the number of California Competes applications has declined and that the average amount awarded per company has increased."¹

Under California Competes regulations, firms apply to the Committee and supply specified information, including, among other items:

- The amount of tax credit requested.
- The description of the proposed project, including whether it is for business growth, retention, or relocation, and the project's timeline and financing.
- The location and number of full-time and part-time employees affected by the project.
- Aggregate employee compensation.
- Average and minimum wage for each classification of full-time employee proposed to be hired or retained.
- Description and average value of benefits and fringe benefits for each classification of full-time employee proposed to be hired or retained.
- Aggregate investment.
- A description of how the tax credit will influence the applicant's ability, or willingness, to create new full-time jobs in this state that might not otherwise be created in the state by the applicant or any other business in California.

¹ Legislative Analyst's Office, "Assessing the Changes to California Competes," March 30, 2020. <https://lao.ca.gov/Publications/Report/5162>

GO-Biz accepts applications during three application periods each year, and then reviews them in two phases. Applicants must apply for at least \$20,000, but the Committee cannot award more than 20% to any single applicant in one fiscal year. In Phase One, applicants calculate the aggregate employee compensation they will pay and the investment they will make if the Committee grants the credit, and then request a credit amount. Applicants are then ranked according to a cost-benefit ratio that measures the compensation and investment amounts versus the amount of credit requested. Applicants with the best ratios move to Phase Two, where GO-Biz negotiates tax credit agreements with the highest-scoring businesses on a case-by-case basis, and also applies the permissive criteria to maximize the benefits received from the credits. However, firms that would expand in a high-unemployment or high-poverty city or county automatically move on to Phase Two, as will applicants where GO-Biz finds that “absent award of the credit, the applicant’s project may/will occur in another state, or the applicant may/will terminate or relocate all or a portion of its employees to another state.”

After Phase Two, the Committee must meet in a public hearing to approve all tax credit agreements. After approval, agreements are posted online.² Agreements include minimum employee compensation and retention period, credit distribution period, and recapture provisions if the taxpayer fails to meet its commitments. Agreements last five years, by which time all employment and investment milestones must be achieved to claim the full credit amount. In addition, these milestones must be maintained for an additional three years. The Franchise Tax Board (FTB) reviews the applicant’s books and records, and in the event of a breach, reports to the Committee, which can then recapture the credit.

In recent years, utilization of the California Competes tax credit has declined. According to FTB, 286 taxpayers claimed \$116 million in credit in the 2022 taxable year, 219 taxpayers claimed \$44 million in credit in 2023, but only 137 taxpayers claimed \$19 million in 2024, although not all 2024 returns had been processed as of the date of the report.³ In its report, FTB states:

“Although FTB does not know the reason for the decline, there are several possible factors that may contribute to a decrease in general credit usage. First, some taxpayers may lack sufficient tax liability to fully utilize the credit, thereby reducing overall application. Second, statutory credit ordering and usage provisions may result in taxpayers using other credits with higher application priority. FTB is aware that not all taxpayers have filed their 2024 tax returns as of the time of this report. A similar circumstance occurred in the prior year’s report, dated March 2025, which resulted in an additional increase of \$12 million in claimed credits for taxable year 2023. It is anticipated that this may likely occur in the current year’s report for taxable year 2024. These factors may account for decreases in credit utilization, but other factors may exist beyond those identified.”

As part of its March 18, 2026, assessment of Cal Competes, LAO states that “For awards made between 2014 and 2020, the recapture rate is almost 55 percent. This indicates that around half

² <https://business.ca.gov/california-competes-tax-credit/awardee-list/#>

³ <https://www.ftb.ca.gov/about-ftb/data-reports-plans/california-competes-tax-credit-report-march-2026.pdf>

of the net job increases and investments promised in negotiated agreements ultimately never come to fruition or are not maintained long-term.⁴ LAO adds that:

“On one hand, high recapture rates can be seen as not a significant issue, and even a sign that the program is working as intended: Companies are incentivized by a tax break if they manage to achieve agreed-upon job and investment targets, but if they fail to do so, the state incurs no expense since the credit is never claimed or is paid back to the state. In other words, there is no explicit downside risk of making the award.”

One year after temporarily increasing the annual allocation from \$180 million to \$280 million in 2021 (AB 150, Committee on Budget), the Legislature extended the Committee’s allocation authority through the 2027-28 fiscal year, among other changes (AB 194, Committee on Budget, 2022). However, statute provides that the allocation authority for any year includes recaptured credits, as well as any unallocated credits, from previous years; Cal Competes awarded only \$101 million in 2022-23, and \$75 million in 2024-25, down from a peak of \$395 million in 2021-22 (incorporating the additional \$100 million from AB 150). As a result, LAO notes that “consistently high recapture rates combined with a lower than usual award volume over the last few years has led to the rapid growth of the credit pool that now stands at \$923 million.”

Cal Competes Grants. In response to the scant benefit of nonrefundable tax credits to firms with little to no tax liability, Governor Newsom proposed grants as an alternative to tax credits as part of his 2021-22 Proposed Budget. Modeled from the tax credit program, the Legislature enacted the proposal as part of the Budget Act, allocating \$120 million in grants (SB 151, Committee on Budget & Fiscal Review), with priority to applicants whose grant will be used as a state match to apply for federal incentives that support the semiconductor industry. After the Legislature approved another \$120 million for Cal Competes grants in the 2022 and 2023 Budget Acts, it did not approve Governor Newsom’s proposal for \$60 million in annual additional grants in the last two Budget Acts.

Governor’s Proposed 2026-27 Budget. Although California Competes’ authority to allocate credits does not sunset until after the 2027-28 fiscal year, Governor Newsom proposed a five-year extension as part of his Proposed Budget. Except for a conforming change to similarly extend the taxable years in which taxpayers can claim credits, the Governor did not propose any substantive changes to the credit. As part of its assessment noted above, LAO recommended the Legislature approve the Governor’s Proposal.

With California Competes’ authority to allocate credits set to expire in two years, and credit utilization declining, the author wants to allow refundable credits for taxpayers in specific industries.

Proposed Law

Senate Bill 1120 makes the following changes to the California Competes Tax Credit Program under the Personal Income and Corporation Taxes:

⁴ <https://lao.ca.gov/Publications/Report/5162>

- Extends for five years the authority for the California Competes Tax Credit Committee to allocate tax credits from 2027-28 to 2032-33, the taxable years that taxpayers can claim them from 2030 until the 2035 taxable year, and the statutes' repeal dates.
- Allows a taxpayer in a strategic industry, as defined, to elect for the credit to be refundable.
- Defines "strategic industry" as industries involved in developing nuclear fusion technologies, quantum technology, or other industries identified in the California Jobs First State Economic Blueprint.
- Requires GO-Biz to inform FTB if, under the agreement, the applicant intends for the credit to be refundable.
- Authorizes refunds from the Tax Relief and Refund Account, beginning in the 2026 taxable year and ending after the 2034 taxable year.

State Revenue Impact

Pending.

Comments

1. Purpose of the bill. According to the author, "Cal Competes is one of the main drivers for bringing new businesses and jobs to California and keeping existing companies here. But more needs to be done to ensure that the program reaches its full potential. SB 1120 will ensure that Cal Competes is fully utilized and spurs innovation and job creation throughout the state, especially in burgeoning clean economy industries."

2. Are refundable credits the right way? Nonrefundable credits do not benefit some taxpayers for two reasons. First, taxpayers use other tax deductions and credits, most commonly the Research & Development Tax Credit and the Net Operating Loss deduction, to reduce tax liability to zero. Second, startup firms often generate losses for many years before turning a profit, if ever, at which point the credit carry forward period expires. While the California Competes Grant program sought to create incentives parallel to the tax credit for firms meeting these characteristics to locate and grow in California, the Legislature allowed it to lapse due to the state's fiscal challenges. SB 1120's refundable credits would serve as a strong incentive for these firms but would cost General Fund revenue, as tax refunds are paid before the Legislature appropriates revenue in the Budget Act. Refundable credits also allow firms to not only pay no income taxes, but to receive cash refunds for any remaining credit value after taxes have been reduced to zero, unlike all other taxpayers. With that said, the Legislature already set a precedent when providing refundable tax credits for the television and motion picture production industry in response to fierce competition from other states and nations.

3. Assessing performance. Tax benefits directed at specific industries do two things. First, they reward behavior that would have occurred anyway. Some taxpayers will engage in business in the state; in these instances, the state receives no marginal benefit and provides a windfall benefit to these firms at the cost of public services. Second, the benefit generates additional employment, wage payments, and economic activity resulting from the taxpayer's business that would not be generated but for the credit; the incentive will lower costs at the margin in amounts necessary for the taxpayer to locate and grow in California. A successful tax credit results in more economic activity at the margin than its windfall benefit. The California Competes Tax Credit may be the first tax credit that passes this test, according to two separate studies. One

found that in its first four years, the credit created jobs for residents of both low-income and high-income areas and had important multiplier effects, specifically that each job that qualified the applicant for a credit in a census tract increases the number of individuals working in that tract by over two times.⁵ The other found that the program induces employment and payroll growth in California, primarily due to business expansions rather than new business sitings, with a disproportionate amount of program-induced growth attributable to firms in more economically disadvantaged parts of the state.⁶

4. Who benefits? SB 1120 allows successful California Competes applicants in “strategic industries” to claim refundable credits, so long as they are “involved in developing nuclear fusion technologies, quantum technology, or other industries identified in the California Jobs First State Economic Blueprint.” In that respect, SB 1120 follows the precedent of SB 86 (McNerney, 2025), which added fusion energy as an eligible alternative source to the California Alternative Energy and Advanced Transportation Financing Authority’s (CAEATFA’s) Sales and Use Tax Exclusion program. However, the definition of “strategic industries” could benefit from additional clarity, even if the Committee must approve any tax credit agreement under the bill that awards refundable credits. First, the bill allows applicants to be “involved” in an industry, rather than “engaged” or “primarily engaged,” as with other tax credits. Second, while the California Jobs First State Economic Blueprint is a thorough description of the state’s economic strengths, it doesn’t specify many “industries,” instead broadly describing sectors.

5. Something new. As noted above, SB 1120 explicitly defines as a “strategic industry” industries involved in nuclear fusion and quantum technologies. When atoms are fused, they create an intense heat that can be used to generate electricity. According to General Atomics, California hosts two of the nation’s largest fusion research centers and supports 20,000 jobs in the eight fusion companies headquartered here. In 2024, the Legislature defined fusion energy when adding it to the state’s Integrated Energy Policy Report (AB 1172, Calderon). While still in its research and development phase, quantum computing seeks to outperform classical computers on certain tasks, potentially enabling discoveries for applications in medical devices, navigation, mineral discovery, secure information transfers, and material science.

6. Timing is everything. As a non-urgency measure, the bill would take effect on January 1, 2027, if approved by the Legislature and signed by the Governor. However, its refundable credits commence in the 2026 taxable year, and require taxpayers in a strategic industry to elect at the time of applying for the credit, or within six months of this bill’s effective date, to make their Cal Competes Credit refundable. The earliest a taxpayer could apply for a credit with GO-Biz and elect to have their credit refundable would be at some point next year, which may be after taxpayers are required to file their 2026 tax returns. Additionally, while SB 132 allowed an election for taxpayers to receive refundable Television and Motion Picture Production Credits, it provided that the state could only pay refunds over a five year schedule. SB 1120 does not contain a similar schedule.

7. Technicals. Committee staff recommends the following technical amendments:

⁵ Matthew Freeman, David Neumark, and Shantanu Khanna, “In Combining Rules and Discretion in Economic Development Policy: Evidence on the Impacts of the California Competes Tax Credit,” (NBER Working Paper 28594). March 2021: <https://www.nber.org/papers/w28594>.

⁶ Benjamin G. Hyman, Matthew Freeman, Shantanu Khanna, and David Neumark, “Firm Responses to State Hiring Subsidies,” (NBER Working Paper 30664). January 2023: <https://www.nber.org/papers/w30664>.

- On Page 4, Line 4, and Page 11, Line 38, strike out “if the taxpayer intends for the credit to be refundable,” and replace with “if the taxpayer has made an election for the credit to be refundable,”
- On Page 5, line 20, replace the “and” with “or.”
- On Page 6, lines 28 through 38, strike out paragraph (2) of subdivision (e) and replace with:

(e)(2)(A) For taxable years beginning on or after January 1, 2026, and before January 1, 2035, if the taxpayer is in a strategic industry and makes an election for the credit to be refundable, if the credit allowed under this section exceeds the tax for the taxable year, the excess shall be credited against other amounts due, if any, and the balance, if any, shall be paid from the Tax Relief and Refund Account and refunded to the taxpayer.

(B) The election shall be made in the form and manner prescribed by GO-Biz at the time of applying for the credit, or within six months of the effective date of this paragraph.

- On page 14, lines 22 to 32 strike out paragraph (2) of subdivision (e) and replace with:

(e)(2)(A) For taxable years beginning on or after January 1, 2026, and before January 1, 2035, if the taxpayer is in a strategic industry and makes an election for the credit to be refundable, if the credit allowed under this section exceeds the tax for the taxable year, the excess shall be credited against other amounts due, if any, and the balance, if any, shall be paid from the Corporation Tax Fund and refunded to the taxpayer.

(B) The election shall be made in the form and manner prescribed by GO-Biz at the time of applying for the credit, or within six months of the effective date of this paragraph.

Support and Opposition (4/3/26)

Support: Silicon Valley Leadership Group (Sponsor)
California Life Sciences
California Manufacturers and Technology Association
Herrera & Company
Lucid Motors

Opposition: None received.

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