



## Sales Rule in CA's '10 Budget Could Make State More Attractive to Life-Sci Shops, Exec Says

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By Alex Philippidis

California's recent decision to cut corporate income taxes for life-science companies and many other employers as of 2011 by changing how they can calculate what they owe is likely to boost the state's odds of attracting more biomanufacturing activity, according to the CEO of an expansion-minded biopharma headquartered in the state.

"With what the legislature has done, that will help to essentially allow for more growth, and we'd be more inclined to do that growth inside the state," Steven Engle, chairman and CEO of Xoma, a maker of recombinant proteins and peptides, told *BioRegion News* earlier this month.

Engle spoke days after Gov. Arnold Schwarzenegger signed into law a \$130 billion budget for the period ending June 30, 2010, following approvals by the state's House of Representatives and Senate.

The budget includes the new single-source factor measure, which would benefit many life-sci and other multi-state businesses by allowing them to determine the percentage of corporate income or "franchise" taxes they owe the state based solely on their sales, rather than combining double-weighted sales with two other factors: the size of their payroll and the amount of property they own.

By comparison, current law calculates each factor as a ratio of in-state activity to activity everywhere.

The single-source sales factor would take effect with the fiscal year starting Jan. 1, 2011. That year, the law is projected to generate 21,180 new jobs in California and more than \$1.1 billion in state income, according to a study by Ernst & Young furnished by BayBio, the industry group for life-sciences employers based in the San Francisco Bay Area and northern California. By 2015, the law will have created 37,529 new jobs and generated more than \$3.3 billion in personal income, according to the [study](#).

How many of those jobs and how much of that income will come from the life sciences is not known, since the study did not offer an industry-by-industry breakdown of the job or personal income gains.

“Theoretically, all of our members should benefit from it,” though short-term that number would be at least 10 percent, or 130, of the state’s public life-sci companies, Matthew Gardner, president and CEO of BayBio, told *BRN* earlier this month.

Though BayBio counts more than 1,000 biotech, pharma, and medical-device companies in northern California, many of those members would not likely benefit for a decade or more since life-sci companies usually need at least that long to begin generating revenue.

California has set three guidelines that define activity within the state. Receipts from services are counted as being generated in the state if: the purchaser of the service received the benefit of the service in the state; if receipts from intangible property are in the state to the extent that a property is used in the state; and if that property is in the state, then receipts from selling, leasing, renting, or licensing of real or tangible property can be counted as in-state.

Not eligible for the new single-source sales formula are businesses that derive more than half of their sales from agriculture, “extractive” business like mining, savings and loans, or banks and financial activities. Those businesses will continue to be subject to the Golden State's existing three-factor formula, according to the budget.

The new law "benefits California-based service companies that have a significant out-of-state customer base. However, many service companies with significant operations outside of California will likely see a substantial California tax hike resulting from the switch from costs-of-performance to market-based sourcing," Michele Borens and Jeffrey Friedman, lawyers in the State and Local Tax Practice of the law firm Sutherland Asbill & Brennan, wrote in a Feb. 24 [article](#) on the change.

For his part, Xoma's Engle said he could not quantify how much money the law could enable his company to save, but did say it was a welcome move toward making California more competitive against other states seeking to attract more biomanufacturing plants.

One such state is Texas, where officials from the Texas A&M university system last September signed a memorandum of understanding with Xoma to co-construct a Good Manufacturing Practices facility and co-develop antibodies and protein-based therapeutics for human and veterinary applications [see sister publication [Biotech Transfer Week, Sept. 17.2008](#)]

“We just have a memorandum of understanding; we don’t have funding. So it’s still in a planning stage, if you will,” Engle said. “Sometimes, people have this feeling that, ‘We love the state of California. We enjoy the beauty, and all that.’ But there’s another part: it’s that you’ve got to be able to grow your company, and you’re looking for whatever advantage you can when you’re at earlier stages. So those trade-offs between the states come into people’s thinking.

“I think that this single tax factor is one of those where you don’t want to see the state of California penalized as a long-term player, because then people start to think there’s a play over

in Utah [or] Oregon, or wherever, and no taxes," he said. "And they start thinking, 'Well, geez, does that make more sense?'"

Engle added, however, that the absence of the single-source sales formula in California was not a factor in Xoma's recent decision to lay off 42 percent of its workforce, or 144 employees, most of which were in manufacturing. The move, announced Jan. 15, caused the company to record a \$3 million charge against first-quarter earnings.

In its 10-K [annual report](#), filed March 11 with the US Securities and Exchange Commission, Xoma said it could "further reduce personnel-related costs" as a result of an anticipated drop in royalties from the sale of Raptiva, a drug designed to treat chronic moderate-to-severe plaque psoriasis.

In 2008, Xoma earned royalties of \$12.2 million from worldwide sales of the drug, compared with \$10.6 million in 2007 and \$8.2 million in 2006. But recent events could hurt its ability to generate revenue from sales of the drug, which the company said could in turn hamper its ability to repay a loan from investment bank Goldman Sachs, and threaten its ability to remain in business.

Those events include a decision last November by the US Food and Drug Administration to demand the company add a Black Box warning highlighting the drug's risk of progressive multifocal leukoencephalopathy, or PML, and other life-threatening infections in certain patients; a decision in February from the European Medicines Agency, citing those potential adverse events, in its recommendation to suspend the drug's marketing authorization in the European Union; and a move last month by EMD Serono, which markets the drug in Canada, to suspend its efforts in that country for similar reasons, according to a company news release.

"In the event we are not able to restructure the terms of our loan from Goldman Sachs and otherwise maintain at least [12] months of cash resources, there will be substantial doubt as to our ability to continue as a going concern," Xoma added in its SEC statement.

Xoma has a substantial number of staffers and facilities in California, though because much of its sales are generated outside the state, the firm is likelier to benefit from the new single-source factor measure than other state-based companies.

### **Breathing New Life-Sci**

The new law caps more than five years of lobbying by the state's life-sci industry for the change — starting with a policy recommendation in [Taking Action for Tomorrow: California Life Sciences Action Plan](#), released in 2004. That report concluded that the triple-source formula "provides a disincentive to locate additional facilities (and jobs) in California and discourages new life-sciences companies and facilities from moving to the state."

Gardner said the new single-source regulation marks the third straight year that Schwarzenegger and state lawmakers have approved a change in state law sought by life-sciences advocates. Indeed, last year another recommendation from the *Action Plan* became law when Schwarzenegger agreed to double, from 10 to 20 years, the amount of time life-sci

companies can carry forward tax deductions on their net operating losses. The decision fulfilled a promise he made while addressing the Biotechnology Industry Organization's 2008 International Convention in San Diego [*BRN*, [Sept. 22, 2008](#); [June 23, 2008](#)].

And in 2007 and 2008, California officials aided the industry by creating a fast-track permitting process, and by revising the state fire code to create a second "L" occupancy classification for industrial laboratories. Yet another change, drafted last year, enables life-science companies and lab developers to construct laboratory buildings four or more stories tall. [*BRN*, [Oct. 6, 2008](#); [Oct. 1, 2007](#)]

"We keep chipping away at those action items given the state's [fiscal] circumstances, and the state continues to be supportive of life sciences in every creative way possible, even given the budget circumstances," said Gardner.

California is one of 22 states that either have or will soon adopt single-source sales formulas — and joins two other states in implementing the tax-cutting measure in 2011. Indiana will adopt single-source sales the same day as California, while South Carolina will finish phasing it in.

Another state, Minnesota, will adopt single-source sales on Jan. 1, 2014.

Already using single-source sales formulas are Colorado, Connecticut, Georgia, Illinois, Iowa, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, New York, Ohio, Oregon, Texas, Virginia, and Wisconsin.