Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Maze	Analyst:	Darrine Distefano	Bill Number:	AB 1856
Related Bills:	See Legislative History	Telephone:	845-6458	Amended Date:	04-12-04
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Targeted Tax Areas/Credits/Department of Housing & Community Development Approve Expansion of No More Than 15%

SUMMARY

This bill would make various changes to the Targeted Tax Area (TTA) provisions.

This analysis will not address the bill's provision regarding government contracts that would be performed within a TTA.

SUMMARY OF AMENDMENTS

The April 12, 2004, amendments deleted provisions related to the apportionment of business income in the TTA, qualified property for the sales and use tax credit, and provisions related to eliminating the reference to the Job Training Partnership Act. The remaining provisions of the bill as introduced February 2, 2004, are discussed below.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to expand TTA benefits to businesses on the border of the TTA that will further enhance the economy of Tulare County.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative beginning for taxable years on or after January 1, 2004. However, the extension of existing incentives to those taxpayers not previously eligible would be operative for taxable years beginning on or after January 1, 2005.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law does not have economic development areas with provisions similar to TTAs. Federal law provides for economic development areas called empowerment zones and enterprise communities, which are eligible to receive two tax incentives: (1) tax-exempt private activity bonds to finance certain facilities; and (2) the "brownsfields" tax incentive, which allows taxpayers to expense (rather than capitalize) certain environmental remediation expenditures. Qualified empowerment zone businesses are allowed an additional $20,000 depreciation expense deduction.

Board Position:						Department Director	Date
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Existing state law, under the Government Code, allows for the designation of a TTA. Using specified criteria regarding unemployment, income levels, poverty levels, and percentages of residents receiving Aid to Families with Dependent Children, Tulare County was designated as a TTA. The designation was made November 1, 1998, and is to remain in effect for 15 years beginning January 1, 1998. This is the only TTA designation made.

Certain taxpayers conducting business activities in a TTA are permitted special tax incentives under the Revenue and Taxation Code. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. These incentives are also available to businesses operating in an enterprise zone (EZ), Local Agency Military Base Recovery Act (LAMBRA), and Manufacturing Enhancement Area (MEA). Along with the TTA, these areas are collectively known as economic development areas (EDAs).

Under the hiring credit in the EDA, a qualified individual at the time of hire must be one of the following: eligible for services under the federal Job Training Partnership Act (JTPA), or the Greater Avenues for Independence (GAIN) Act of 1985; an economically disadvantaged youth; a qualified dislocated worker; disabled; a military veteran; an ex-offender; eligible for or a recipient of Supplemental Security Income (SSI), Aid to Families with Dependent Children (AFDC), food stamps, or state and local general assistance; a Native American; a resident of the EDA; or a member of a targeted group as defined under federal law.

From 1983 until June 30, 2000, JTPA directed and funded the largest federal employment-training program in the nation, serving dislocated workers, homeless individuals, economically disadvantaged adults, youths, and older workers. On July 1, 2000, the Workforce Investment Act (WIA) of 1998 replaced JTPA. WIA affects many other federally funded employment and training, literacy and vocational rehabilitation programs, coordinating a vast range of federally funded jobs programs offered by many U.S. government departments and agencies. Although the WIA was enacted following the JTPA, Congress did not specify that the WIA was to succeed the JTPA.

The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an EDA (except a MEA). The amount of the credit is limited to the tax attributable to EDA income. Qualified property is defined as follows:

EZ or TTA:

- Machinery and machinery parts used for:
    - Manufacturing, processing, assembling, or fabricating;
    - Producing renewable energy resources; or
    - Air or water pollution control mechanisms.
- Data processing and communication equipment.
- Certain motion picture manufacturing equipment.

Beginning in 1984, Technology, Trade, and Commerce Agency (TTCA) administered the EZ Act (which includes the MEA), along with the LAMBRA and TTA program. Due to the elimination of funding for TTCA by the 2003-04 Budget Act, only the administration of the EZ Act was transferred to Department of Housing and Community Development (DCHD).

THIS BILL

This bill would remove the reference to TCA and insert Department of Housing and Community Development (DHCD) as the designating authority for TTAs.

This bill would require DHCD to approve expansion of the existing TTA by no more than 15%, if the increased area meets the necessary criteria to be a TTA (unemployment, income levels, poverty levels, and percentages of people receiving Aid to Families with Dependent Children, based on the 1995-96 Cash Grant Caseload Movement and Expenditures Report). It would also require the governing body of each city, county, and city and county in which the TTA is located to approve an ordinance or resolution approving the proposed expansion.

This bill would amend existing law to add taxpayers engaged in agricultural services and business services to the list of trades or businesses that may claim the tax incentives available in a TTA. Any taxpayer engaged in any of these lines of business that would be added would be able to apply the tax incentives available in the TTA for taxable years beginning on or after January 1, 2005.

- Agricultural services would include soil preparation, crop planting and harvesting, veterinary, livestock and animal services, farm labor and management, and landscape and horticultural services.
- Business services would include advertising, consumer credit reporting agencies, mercantile reporting agencies, adjustment and collection agencies, mailing, reproduction, commercial art and photography, and stenographic services, services to dwellings and other buildings, miscellaneous equipment rental and leasing, personnel supply services, computer programming data processing, and other computer related services, and miscellaneous business services.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 641 (Briggs, 2001/2002) was identical to this bill, except for the reference to DHCD. AB 641 failed to pass out of the first house by January 31 of the second year of the session.

AB 2090 (Reyes, 1999/2000) would have allowed expansion of a TTA by up to 15%, and would have added certain crop preparation services to the lines of businesses that may claim the tax incentives applicable in a TTA. AB 2090 failed to pass out of Assembly Appropriations.

OTHER STATES' INFORMATION

Currently, 29 other states have economic development areas that provide similar tax related incentives to those provided in California's economic development areas. The number of economic development areas varies from state to state. For example, California currently has 49 EDAs (that include EZs (39), MEA (2), LAMBRA (7), and TTA (1)), New York has 71, Florida 51, Illinois 93, and Michigan 33.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on limited data and assumptions discussed below, the estimated revenue impact of this proposal is as follows:

Revenue Impact of AB 1856 (As amended April 12, 2004) For Taxable Years After 12/31/2004			
	2004/2005	2005/2006	2006/2007
Revenue Loss	-$500,000	-$5 million	-$5.5 million

Revenue Discussion

The extent of revenue losses would largely depend on the number of businesses in the existing targeted tax area doing business in the areas of agricultural and business services and amount of taxes offset by the hiring credit, sales and use tax credit, net operating loss deduction, and business expense deduction tax incentives.

A substantial revenue impact comes from the added eligibility for agricultural services (and to a lesser extent, business services). Tulare County is a predominately agriculture-based local economy with an agricultural employment base *roughly three times* the number of those employed in the manufacturing, transportation, and communication/utilities industries currently eligible for the hiring credit. Employment in the business services industry is roughly the same as for qualified employment under current law. This bill would result in a quadrupling of the total eligible employment base (3:1 for agricultural plus 1:1 business services equals 4), but the projected tax liabilities of agricultural and business services firms are estimated to average one-third (33%) of currently eligible manufacturing, transportation, and communications/utilities firms. Therefore, the expansion to agricultural and business services could more than double revenue losses under current law for 2005 (a factor of 1.33, increase in employment base (4) X (33%) relative tax liabilities, multiplied by $3.8 million (current law impact) = $5 million).

The expansion of the geographic boundaries up to 15% would produce potential additional revenue losses to the extent the DHCD can ascertain whether a proposed expansion meets the requisite criteria. For this analysis, it is assumed a proportionate relationship exists between size of a TTA and amount of tax incentives allowed. A proportionate loss in revenue assumes the 15% expansion would occur over a five-year period at an expansion rate of 3% per year starting in 2006 (delay based on a strict approval/allocation process). This produces an insignificant revenue impact of under $150,000 annually for the following five years.

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