SCS Agency
Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills: See Legislative History | Telephone: 845-3410 | Introduced Date: 01/27/97

Attorney: Doug Bramhall | Sponsor: City of Brawley

SUBJECT: Enterprise Zones/Authorizes Additional Designation If Specified Criteria Is Met

SUMMARY

Under the Government Code, this bill would require the Trade and Commerce Agency (TCA) to designate an unspecified number of additional enterprise zones. This bill would specify that TCA could designate only cities that meet certain additional criteria.

This bill would provide that all tax incentives provided to existing enterprise zones under the Revenue and Taxation Code would apply to enterprise zones designated under this bill.

EFFECTIVE DATE

This bill would be operative on January 1, 1998.

LEGISLATIVE HISTORY

AB 296 (Stats. 1996, Ch. 953), SB 715 (Stats. 1996, Ch. 952), SB 2023 (Stats. 1996, Ch. 955); SB 712 (Stats. 1995, Ch. 494); AB 2206 (Stats. 1994, Ch. 853), SB 1438 (Stats. 1994, Ch. 754), SB 1770 (Stats. 1994, Ch. 755).

PROGRAM HISTORY/BACKGROUND

California has three types of economic development areas that have similar tax incentives:

Enterprise Zone (EZ),
Los Angeles Revitalization Zone (LARZ), and
Local Agency Military Base Recovery Area (LAMBRA).

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Department Director Position:	Agency Secretary Position:	**GOVERNOR'S OFFICE USE**
____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR ________ PENDING	____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO ____________	Position Approved ____ Position Disapproved ____ Position Noted ____
Department Director	Agency Secretary Date	By: Date:

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LARZ	LAMBRA
Sales or Use Tax Credit	X	X	X
Hiring Credit	X	X	X
Construction Hiring Credit		X	
Employee Wage Credit	X		
Business Expense Deduction	X	X	X
Net Interest Deduction	X	X	
Net Operating Loss	X	X	X

SPECIFIC FINDINGS

Existing federal law specifies empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas. The Secretary of Housing and Urban Development and the Secretary of Agriculture designated nine empowerment zones and 95 enterprise communities from areas nominated by state and local governments (one enterprise community in Imperial County and one enterprise community in Watsonville). In addition, the Secretary designated two supplemental enterprise zones (one in Los Angeles) and four enhanced enterprise communities (one in Oakland).

Qualified zone businesses operating in federal empowerment zones and enterprise communities are eligible to finance property with exempt facility private activity bonds. This exempt bond is the only tax incentive available to businesses operating in enterprise communities. Two additional tax incentives are available in empowerment zones: qualified empowerment zone businesses are allowed an additional $20,000 depreciation expense deduction, and employers are entitled to a 20% tax credit for the first $15,000 of wages paid to certain empowerment zone employees.

State or local governments in which empowerment zones and enterprise communities are designated are eligible to receive block grants for social services and economic development block grants for use in accordance with the strategic plan submitted by the state or local government in the designation nomination process.

The state or local governments in which supplemental empowerment zones and enhanced enterprise communities are designated receive economic development grants and social services grants. Businesses that operate in these areas receive no special tax benefits.

Existing federal law has established the Border Environment Cooperation Commission (BECC), which assists local communities within the border region (62 miles on either side of the U.S./Mexico border) in developing and implementing environmental infrastructure projects and certifies projects for North American Development Bank financing. The BECC assists states and localities, other public entities, and private investors in:

- the coordination, preparation, development, implementation, and oversight of environmental infrastructure projects;
- infrastructure planning, design, construction management, operation and maintenance;
- assessment of technical and financial feasibility of projects;

- evaluation of social, environmental, and economic benefits and costs of projects;
- development of a comprehensive public outreach and participation plan;
- promotion of sustainable development; and
- organization, development, and arrangement of public and private financing for projects.

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an enterprise zone. Using specified criteria, the TCA designates enterprise zones from the applications received from the governing bodies. The Enterprise Zone Act authorizes a total of 39 enterprise zones. Each enterprise zone is authorized for 15 years, and all but one authorized designation has been made.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within an enterprise zone. These incentives include the business expense deduction, special net operating loss treatment, net interest deduction, hiring credit, construction hiring credit, and sales or use tax credit. In addition, a wage credit may be claimed by specified employees of businesses operating within an enterprise zone. Attachment A details each of these incentives.

SB 200 would require the TCA to designate an unspecified number of additional enterprise zones. To qualify for designation as an enterprise zone under this bill, each city must meet the existing enterprise zone criteria, each of the first three criteria listed below, and at least one of the remaining five criteria listed below:

1. The unemployment rate in the county must have been three times the state average from 1990 to 1995.
2. The applicant city or portions of the city must be within a designated federal enterprise community or empowerment zone.
3. The applicant city must be located within the BECC region.

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4. The population of the designated area must have grown by less than 5% in each of the past two years.
5. The median household income for the designated area is under $25,000.
6. The designated area must have a population of less than 20,000.
7. The designated area must be located in a county with a population that is at least 51% non-Anglo.
8. The designated area must be located in a rural community.

This bill would specify that all tax incentives provided to existing enterprise zones under the Revenue and Taxation Code would apply to new enterprise zones designated under this bill.

Currently, the only cities that could meet criteria 2 and 3 above are Brawley, Calexico, and Calipatria, which are located within the federal Imperial County Rural Enterprise Community and are within the BECC region. Calexico received designation as a state enterprise zone under existing law on October 15, 1986.

Implementation Considerations

Implementing this bill would occur during the department’s normal annual system update.

Technical Considerations

This bill raises the following technical considerations:

1. The criterion regarding three times the state average unemployment refers to “the county.” It is unclear whether the reference to “the county” means the county in which the applicant city is located.

2. The criterion regarding less than 5% population growth refers to the “preceding” two years. It is unclear what determines the point in time from which this time period is measured.

3. The criterion regarding a federal enterprise community or empowerment zone incorrectly refers to Chapter 120 of Title 42 of the United States Code. That chapter is the expired authority for designation of federal enterprise zones, none of which were ever designated. The correct reference should be Subchapter U (commencing with Section 1391) of Chapter 1 of Subtitle A of Title 26 of the United States Code.

4. The applicant city would be required to meet the criteria that are listed as numbers 2, 7, and 8 in the bill, as well as one other criterion. The bill would read easier if the required criteria were rearranged as the first three in the list, with the optional criteria listed as numbers 4 through 8.

FISCAL IMPACT

Departmental Costs

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

Tax Revenue Estimate

The revenue loss for each additional designated enterprise zone is estimated to be:

Revenue Impact For Each Additional Enterprise Zone Effective January 1, 1997 Enacted After June 30 1997 (in millions)		
1997-8	1998-9	1999-0
Minor Loss*	Minor Loss*	($1)

* Less than $500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Revenue losses under the Personal Income Tax Law and the Bank and Corporation Tax Law would depend on the number of businesses that would purchase qualified property subject to the sales tax, the amount of wages paid to qualifying employees, and the state tax liabilities of employers claiming tax benefits.

The above estimate is based on state data that indicate tax liabilities for all enterprise zones were reduced by $16.9 million for the 1993 income/taxable year. Although the data for 1994 are incomplete, to date they indicate that tax liabilities were reduced by approximately $21 million.

Because the effectiveness of a new zone is unknown and the potential exists for significant businesses to locate in a zone, the average revenue loss of $1 million per zone per year has been used. However, for the first two years based on the existing zone of Calexico, it is anticipated the loss would be less than $500,000. (Currently businesses in Calexico, which is an existing enterprise zone, are realizing a tax benefit of less than $20,000.) This bill focuses on the California-Mexico border, where economic activity is expected to change significantly in the near future due to increasing public attention and policies such as NAFTA. An aggressive local planning effort could direct much of the new development into an enterprise zone such as proposed by this bill.

For example, one border community that could be eligible for EZ designation has planned an investment program intended to encourage expansion of existing and emergence of new businesses to take advantage of NAFTA for job creation in a new port of entry. These efforts have a goal of creating 4,500 public sector jobs and 100 new businesses. If the new zone were created in this community, the revenue impact would be significantly greater than if located in a less aggressive community.

POSITION

Neutral.

The staff's position is determined by administrative considerations and does not take into account tax policy considerations or revenue impact on the state. However, these issues are discussed in the analysis.

SB 200
As Introduced January 27, 1997
Attachment A

Tax incentives available to businesses that operate within enterprise zones:

Enterprise Zone Business Expense Deduction

A business located in an enterprise zone may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the enterprise zone. The deduction is allowed in the taxable year in which the taxpayer places the qualified property in service. The election must be made on the original return. The basis of the property must be reduced by the amount of the deduction. The maximum deduction for all qualified property is the lesser of 40% of the cost or the following:

If the property was placed in service:

Months after designation	Maximum deduction
0 to 24	$40,000
25 to 48	30,000
48 and over	20,000

Enterprise Zone Net Operating Loss Deduction

A business located in an enterprise zone may elect to carry over 100% of the enterprise zone net operating losses (NOLs) to deduct from enterprise zone income of future years. The enterprise zone NOL is determined by computing the California business loss then applying a percentage (apportioning) to calculate the enterprise zone portion of the California loss.

Enterprise Zone Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone, and the lender may not have equity or other ownership interest in the enterprise zone trade or business.

Enterprise Zone Hiring Credit

A business located in an enterprise zone may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated an enterprise zone and meet certain other criteria. At least 90% of the qualified employee’s work must be directly related to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on enterprise zone income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage. The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer’s deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Enterprise Zone Sales or Use Tax Credit

The enterprise zone 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 enterprise zone and is limited to the tax attributable to enterprise zone income. Qualified machinery is defined as machinery and machinery parts used to (1) manufacture, process, combine, or otherwise fabricate a product; (2) produce renewable energy resources; or (3) control air or water pollution. In addition, qualified machinery must be purchased and placed in service before the enterprise zone designation expires. The maximum value of property that may be eligible for the enterprise zone sales or use tax credit is $1 million for individuals and $20 million for corporations.

Enterprise Zone Employee Wage Credit

Certain disadvantaged individuals are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5% of “qualified wages,” defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone computed as though that income represented the taxpayer’s entire taxable income.