

**SUMMARY ANALYSIS OF AMENDED BILL**

Author:   Arambula   Analyst:   Nicole Kwon   Bill Number:   AB 1398    
 Related Bills:   See Prior Analysis   Telephone:   845-7800   Amended Date:   January 7, 2008    
 Attorney:   Douglas Powers   Sponsor: \_\_\_\_\_

**SUBJECT:** Geographically Targeted Economic Development Area Hiring Credit

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.
- FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2007, STILL APPLIES.
- OTHER – See comments below.

**SUMMARY**

This bill would do the following:

- Suspend individually offered hiring credits within each geographically targeted economic development areas (G-TEDAs).
- Authorize one hiring credit for qualified taxpayers within a G-TEDA.

**SUMMARY OF AMENDMENTS**

The January 7, 2008, amendments would change the hiring credit percentage from 30% of the amount of all qualified wages paid to a qualified employee during each employment year back to 50% of wages paid to “qualified employees” in the first year of employment, decreasing by 10% each year thereafter. In addition, the January 7, 2008, amendments would make various other technical changes.

As a result of the amendments, the “This Bill” and “Economic Impact” discussions have been revised and are provided below. A new “Legal Impacts” section is also provided below. In addition, the unresolved Implementation Considerations and Policy Concern identified on the department’s prior analysis of the bill as introduced on February 23, 2007, are provided below for convenience.

Board Position:	Legislative Director	Date
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## **POSITION**

Pending.

## **ANALYSIS**

### THIS BILL

For taxable years beginning on or after January 1, 2008, this bill would suspend the hiring credits offered separately under each G-TEDA and instead authorize one hiring credit for qualified taxpayers that hire qualified employees within the G-TEDAs.

This bill would define "geographically targeted economic development area" (G-TEDA) to mean an Enterprise Zone (EZ), a Local Agency Military Base Recovery Area (LAMBRA), a Targeted Tax Area (TTA), and a Manufacturing Enhancement Area (MEA) pursuant to specified sections of the Government Code.

This bill would contain "no inference" language that specifies that no inference shall be drawn with respect to the amendments made by this bill both for the existing law sections being amended and for the new sections being added, for any taxable year beginning before January 1, 2008.

In addition, this bill would make the following changes:

- Replace the term "taxpayer" with "qualified taxpayer."
- Replace the "California Job Training Automation System and WIA" with the "federal Job Training Partnership Act."
- Change one criteria of "qualified employee" by replacing a person receiving benefits under the California Work Opportunity and Responsibility to Kids program with a person eligible to be a voluntary or mandatory registrant under the Greater Avenues for Independence Act of 1985 (GAIN) program.
- Change the age of an economically disadvantaged individual from 14 years to 16 years old.
- Change the definition of a "dislocated worker" to an individual who meets any of the following requirements:
  1. Has been terminated or laid off or who has received a notice of termination of layoff from employment.
  2. Has been terminated or has received a notice of termination of employment as a result of any permanent closure or any substantial layoff at a plant, facility, or enterprise.
  3. Is long-term unemployed and has limited opportunities for employment of reemployment in the same or a similar occupation in the area in which the individual reside, including an individual 55 years of age or older.

4. Was self-employed and is unemployed as a result of general economic conditions in the community.
  5. Was a civilian employee of the Department of Defense employed at a military installation being closed or realigned.
  6. Was an active member of the Armed Forces or National Guard as of September 30, 1990, and was either involuntarily separated or separated pursuant to a special benefits program.
  7. Is a seasonal or migrant worker who experiences chronic seasonal unemployment and underemployment in the agriculture industry.
  8. Has been terminated or laid off, or has received a notice of termination or layoff, as a consequence of compliance with the Clean Air Act.
  9. Is a former member of a criminal street gang, as certified by a specified law enforcement agency.
- Add to the criteria for satisfying the definition of veteran: (1) an individual who served in the active military, naval, or air service of the United States between February 28, 1961, and May 8, 1975, and (2) an individual who was discharged or released in the last 48 months from active service in the National Guard if the individual served on foreign soil prior to discharge.
  - Change the definition of a “felon” to mean an individual who has been convicted of a felony or a misdemeanor offense punishable by incarceration, or a person charged with a felony offense or a misdemeanor offense punishable by incarceration but placed on probation by a state court without a finding of guilt.
  - Require the qualified taxpayer located in a targeted tax area to be a resident of that targeted tax area immediately preceding the commencement of employment.
  - Replace the "Standard Industrial Classification (SIC) Manual" with the “North American Industry Classification System Manual”. In addition, the amendments will require the Employment Development Department (EDD) to determine which classifications apply and annually publish them on EDD’s web site.
  - Change the definition of a “qualified taxpayer” to mean a taxpayer that meets any of the following:
    1. Is a person or entity engaged in a trade or business within an enterprise zone.
    2. Is a person or entity engaged in a trade or business within a local agency military base recovery area.
    3. Is a person or entity that meets both: (a) is engaged in a trade or business within a targeted tax area or a manufacturing enhancement area, and (b) is engaged in those lines of business described as industrial in the North American Industry Classification System Manual.

## IMPLEMENTATION CONSIDERATIONS

The department has identified a number of implementation concerns relating to the use of extensive portions of existing incentive provisions in creating the new G-TEDA under sections 17053.76 and 23622.9 of the Revenue and Taxation Code; some of these are identified as examples below. The department has been made aware of these from its experience in administering the existing incentive provisions. Unless these implementation concerns are addressed, enactment of this bill in its current form would hinder the department's ability to administer the provisions of this bill. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill appears to contain no repeal or "render inoperative" date for the carryover provision under subdivision (k) (3) and (l) (3). This creates conflicting information about how to utilize credits generated in taxable years beginning prior to January 1, 2008, and the credits generated in taxable years beginning on or after January 1, 2008. This conflict could result in certain taxpayers utilizing the credits under both of these periods. This conflict could be resolved by amending subdivision (k)(3) as follows: "Notwithstanding this subdivision, the provisions of subdivision (d) of section 17039 shall apply to allow carryover of credits previously authorized by this section to taxable years beginning on or after January 1, 2008."

Under existing law, the amount of allowable credit in any given taxable year is limited by requiring that carryover credits be lumped together with credits from the current taxable year in applying the limitation that credits may only be applied against business income from the economic development area. Under this bill, this limitation is also contained in the proposed new G-TEDA provisions, but the new provisions do not tie utilization of the carryover credits from the old economic development area provisions together with the new G-TEDA provision. As a result, it is possible that a taxpayer could, for example, have a limitation for a taxable year of \$100, while having \$200 in carryover credits from the old economic development area provisions and \$100 from the new G-TEDA provision. Without the old limitations being tied to the new G-TEDA rules, a taxpayer in this example could claim \$100 of carryover credit under the old economic development area rules and another \$100 of credit from the new G-TEDA provisions, thus resulting in a double credit.

The certification requirement in subdivision (c) (1) is not clear as to what is being certified. The clarification of what is being certified could prevent disputes between the department and taxpayers.

The bill contains numerous terms such as "state rehabilitation plan" and "priority for employment" that are undefined. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

The bill provides that the amount of the credit would range from 50% to 10% of qualified wages, depending on years of employment. It is unclear which percentage would apply in all cases. For example, if an employee leaves after 11 months and is then rehired 2 weeks later, would a new 50% credit start for that employee?

## ECONOMIC IMPACT

### Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses:

Estimated Revenue Impact of AB 1398 Enactment Assumed after June 30, 2008 (\$ in Millions)			
	2008-09	2009-10	2010-11
Hiring Credit	-\$25	-\$95	-\$100

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

### Revenue Discussion

The revenue impact of this bill would be determined by the difference between hiring credits generated and applied to reduce tax under the bill and hiring credits generated and applied to reduce tax under current law. An estimate is made that this bill would increase hiring credits applied by approximately 21% or \$90 million for tax year 2008. This revenue loss is primarily due to the ability of taxpayers with EZ, LAMBRA, TTA, and MEA carryover credits to reduce tax by twice the amount of tax imposed on their zone income, once for applying new G-TEDA hiring credits and again for applying existing carryover credits. As existing carryover credits are exhausted, this bill would eventually result in decreased application of hiring credits. Estimation is made that existing carryover credits would be substantially exhausted by the end of year five. The revenue impact was estimated by comparing hiring credits projected to be applied under current law and hiring credits projected to be applied under this bill.

- Under current law, EZ, LAMBRA, TTA, and MEA hiring credits are projected to be approximately \$420 million for tax year 2008.
- Under current law, EZ, LAMBRA, TTA, and MEA credits are limited to the taxpayer's tax on income from the EZ, LAMBRA, TTA, or MEA. Because existing carryover credits would be utilized in accordance with the repealed sections under which they were generated, this bill would allow taxpayers with existing credit carryovers to reduce tax by twice the amount of tax imposed on their zone income, once for applying new G-TEDA hiring credits and again for applying existing carryover credits. Existing carryover hiring credits are estimated to exceed \$1 billion. An estimate is made that the ability to apply hiring credits equal to twice the tax on G-TEDA income will increase the amount of credits applied by approximately 28% or approximately \$118 million for tax year 2008. (\$420 million credits projected under current law x 28% ≈ \$118 million.)

- Under current law, EZ and TTA credits may reduce tax below tentative minimum tax (TMT). This bill makes no amendment to the sections of California law governing utilization of credits below TMT. Therefore, this bill would limit the use of G-TEDA hiring credits to a taxpayer's TMT. However, EZ and TTA carryover credits, which were generated under the repealed hiring credit sections, and EZ and TTA sales or use tax credits would continue to reduce tax below TMT. Estimation is made that the TMT limitation would reduce applied credits approximately \$30 million after offset by increased utilization of other credits. (\$90 million estimated decreased utilization of newly generated credits - \$60 million increased utilization of other credits = \$30 million.)
- Under current law, LAMBRA imposes a \$2 million per taxpayer per taxable year limitation on qualified wages for purposes of the LAMBRA hiring credit. This bill does not limit qualified wages for LAMBRA employees. Removal of the \$2 million per taxpayer per taxable year limitation on LAMBRA qualified wages is estimated to increase applied credits approximately \$1 million.
- To summarize, estimation is made that \$118 million increase in credits applied due to doubling the allowable credit for some taxpayers, minus \$30 million decrease in credits applied due to G-TEDA hiring credits' limitation to TMT, plus \$1 million increase in credits applied due to removal of limit on qualified wages of LAMBRA employees = \$89 million increase in hiring credits applied for tax year 2008.

Taxable year estimates are converted to fiscal year estimates in the table above.

## LEGAL IMPACT

This bill would include in the definition of "dislocated worker" a list of options that would allow the employee to be considered a "dislocated worker" for purposes of determining whether the employee is a qualified employee. One of those options would allow that employee to be considered a dislocated worker if that employee is 55 or older and may be subject to age-related barriers to employment. The California Government Code prohibits discrimination based on listed characteristics including age with respect to any state program or state-funded financial assistance. Thus, the credit in this bill that includes an age-related preference could be construed as discrimination against non-favored age groups and subject to challenge.

This bill would include in the definition of "qualified employee" a list of options that would allow the employee to be considered a "qualified employee" assuming other criteria were met. One of those options would allow that employee to be a qualified employee if that employee was a resident of the targeted employment area during a specified period. The U.S. Supreme Court in *Lunding Et Ux. v. New York Appeals Tribunal et al.* (1998) 522 U.S. 287, found that New York's denial of an alimony deduction to nonresident taxpayers, while allowing such a deduction to resident taxpayers, was discriminatory and thus unconstitutional. Targeted tax incentives such as the credit in this bill that are conditioned on residency in California – even though the bill would not require all qualified employees to reside in the targeted employment area – may be subject to constitutional challenge.

## **POLICY CONCERN**

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

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