

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: De La Torre Analyst: Jahna Alvarado Bill Number: AB 1657

Related Bills: See Legislative History Telephone: 845-5683 Introduced Date: January 15, 2010

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Enterprise Zone/City of Downey

SUMMARY

Under the Government Code, this bill would require the Department of Housing and Community Development (DHCD) to designate a specific area in the City of Downey as an enterprise zone (EZ).

PURPOSE OF THE BILL

The special finding in the bill language indicates that the purpose of this bill is to address the unique circumstances of the City of Downey with respect to the need for sustained employment and business development.

The bill also states that it would address the fiscal emergency declared by the Governor by proclamation on December 19, 2008.

EFFECTIVE/OPERATIVE DATE

If enacted by September 30, 2010, this bill would become effective January 1, 2011, and would be operative as of that date.

POSITION

Pending.

SUMMARY OF SUGGESTED AMENDMENTS

Department staff is available to assist with amendments to resolve the implementation concerns discussed in this analysis.

Table with Board Position (S, SA, N, NA, O, OUA, NP, NAR, PENDING) and Department Director (Selvi Stanislaus) with Date (02/17/10).

## **ANALYSIS**

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

### FEDERAL LAW

Existing federal law provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

### STATE LAW

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 DHCD designates EZs from the applications received from the governing bodies. EZs are designated for 15 years (except EZs meeting certain criteria may be extended to 20 years), and the DHCD is authorized to designate 42 EZs under current law (42 are currently designated). When an EZ expires, the DHCD is authorized to designate another in its place to maintain a total of 42 EZs. The DHCD may approve the geographic expansion of EZs up to 15 percent in size and, for certain small EZs, up to 20 percent in size.

The DHCD may audit EZ programs and determine a result of superior, pass, or fail and may dedesignate failing programs. Any business located in a dedesignated zone that has elected to avail itself of any state tax incentive for any taxable year prior to dedesignation may continue to avail itself of those tax incentives for a period equal to the remaining life of the EZ, provided the business otherwise is still eligible for those incentives. When an EZ is dedesignated, it is no longer an EZ for designation purposes. Thus, when an EZ is dedesignated, the DHCD may designate another EZ in its place to maintain a total of 42 EZs.

Under the Revenue and Taxation Code (R&TC), existing state law provides special tax incentives for taxpayers conducting business activities within an EZ. These incentives include a sales or use tax credit, hiring credit, business expense deduction, special net operating loss treatment, and net interest deduction. In addition, a wage credit may be claimed by specified employees of businesses operating in an EZ. See Attachment A for a detailed discussion of each tax incentive.

### THIS BILL

This bill would require the DHCD, upon application by the Downey City Council, to designate one EZ within the geographic area of the City of Downey.

The EZ would be deemed to have been designated under the Enterprise Zone Act, and would not be counted as an EZ for purposes of calculating the overall number of EZs authorized under the act.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation and policy concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The EZ hiring credit and sales and use tax credit under the Personal Income Tax Law (PITL) and Corporate Tax Law (CTL) are allowable for wages paid to employees hired or qualified assets placed in service on or after the designation date. If it is the author's intention that these incentives would apply to wages paid to employees hired or acquisitions made prior to the zone designation date, this bill should be amended.

### **LEGISLATIVE HISTORY**

ABX6 3 (Blakeslee, Solorio, et al., 2009/2010) would allow the DHCD to designate one special EZ within the City of Fremont consisting of a geographic area encompassing a facility that manufactures automobiles and would allow the DHCD to designate an additional ten special EZs, as specified. The language specifically identifying the geographic area that may be designated as an EZ is similar to the language in this bill. ABX6 3 is currently in the Assembly Rules Committee.

ABX3 82 (Blakeslee, et al., 2009/2010) would have required the DHCD to designate one EZ within the City of Fremont consisting of a geographic area encompassing a facility that manufactures automobiles and would have allowed the DHCD to designate an additional ten special EZs, as specified. The language requiring the designation of a specified geographic area as an EZ is similar to the language in this bill. ABX3 82 failed to pass prior to the adjournment of the third special session of 2009/2010.

SBX6 1 (Correa, et al., 2009/2010) would require the DHCD to designate one special EZ within the City of Fremont consisting of a geographic area encompassing a facility that manufactures automobiles and would allow the DHCD to designate an additional ten special EZs, as specified. The language requiring the designation of a specified geographic area as an EZ is similar to the language in this bill. SBX6 1 is currently in the Senate Rules Committee.

SBX4 32 (Corbett, 2009/2010) would have required the DHCD to designate one EZ within the geographic area of the City of Fremont upon application by the Fremont City Council. This EZ would not be included in the number of EZs authorized under the EZ Act. With the exception of the geographic area that AB 1657 would apply to, the EZ designation language in SBX4 32 is substantially identical to this bill's language. SBX4 32 failed to pass prior to the adjournment of the fourth special session of 2009/2010.

ABX3 35 (Calderon, 2007/2008) would have suspended the EZ tax incentive provisions of the R&TC for taxable years beginning on or after January 1, 2009. ABX3 35 failed passage out of the Assembly Rules Committee.

SB 1876 (Alpert 2003/2004) would have repealed the EZ special tax incentive provisions for tax years beginning on or after January 1, 2013. SB 1876 failed to pass out of the Senate Appropriations Committee.

AB 46 (Stats. 2001, Ch. 587) increased the number of EZs that could be designated from 39 to 42.

SB 130 (Knight, 2001/2002) would have allowed the creation of an additional enterprise zone that meets specified criteria. SB 130 failed to pass out of the first house by the Constitutional deadline.

SB 888 (Dunn, 2001/2002) would have required the Technology, Trade, and Commerce Agency TCA to designate a specific area in southern California as an enterprise zone. SB 888 failed to pass out of the first house by the Constitutional deadline.

AB 356 (Washington, 1999/2000), which would have required the TCA to rank applicants and designate a geographic area within one city in Los Angeles County as an additional enterprise zone was vetoed by Governor Gray Davis. The Governor's veto message, provided as Attachment B, specified that the number of zones must be limited and the areas chosen on a statewide, competitive basis.

## **OTHER STATES' INFORMATION**

The *Florida* Enterprise Zone Act of 1994 was scheduled to be repealed on December 31, 2005, but was re-enacted as the Florida Enterprise Zone Act by chapter 2005-287, Laws of Florida, for an additional ten years, and is now scheduled to be repealed December 31, 2015. Currently, *Florida* has 56 state enterprise zones.

*Illinois* has 95 enterprise zones, *Michigan* has in excess of 150 geographic areas designated as Renaissance Zones, and *New York* has 85 Empire Zones. Each of these states' designated zone programs do not appear to have an expiration date. The states were reviewed due to their similarities to California's economy, business entity types, and tax laws.

## **FISCAL IMPACT**

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

## ECONOMIC IMPACT

### Revenue Estimate

Estimated Revenue Impact Of AB 1657 As Introduced January 15, 2010 Effective For Taxable Years Beginning On Or After January 1, 2011 Enactment Assumed After September 30, 2010 (\$ in Millions)			
2010-11	2011-12	2012-13	2013-14
-\$1	-\$6	-\$12	-\$15

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

## ARGUMENTS/POLICY CONCERNS

Generally, EZ designation is awarded based on a competitive application process. This bill would require the DHCD to award zone designation to a specific area upon receipt of a zone application from a specified applicant, which is unprecedented.

## LEGISLATIVE STAFF CONTACT

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## Attachment A

AB 1657

As Introduced January 15, 2010

### **Sales or Use Tax Credit**

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 EZ. The amount of the credit is limited to the tax attributable to income earned within the EZ. Qualified property is defined as follows:

- 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.

In addition, qualified property must be purchased and placed in service before the EZ designation expires. The maximum value of property that may be eligible for the EZ sales or use tax credit is \$1 million for individuals and \$20 million for corporations.

### **Hiring Credit**

A business located in an EZ may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an EZ and meet certain other criteria. At least 90 percent of the qualified employee's work must be directly related to a trade or business located in the EZ and at least 50 percent must be performed inside the EZ. The business may claim up to 50 percent of the wages paid to a qualified employee as a credit against tax imposed on income earned within the EZ.

The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current minimum hourly wage (under special circumstances for the Long Beach enterprise zone, the maximum is 202 percent of the minimum 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. Certain criteria regarding who may be qualified employees and certain limitations differ between the various economic development areas.

### **Business Expense Deduction**

A business located in an EZ may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the economic development area. The deduction is allowed in the taxable year in which the taxpayer places the qualified property in service. The property's basis must be reduced by the amount of the deduction. For EZs the maximum deduction for all qualified property is the lesser of 40 percent 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

### **Net Operating Loss Deduction**

A business located in an EZ may elect to carry over 100 percent of the EZ net operating losses (NOLs) to deduct from EZ income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the EZ.

### **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 EZ. 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 EZ, and the lender may not have equity or other ownership interest in the EZ trade or business.

### **Enterprise Zone Employee Wage Credit**

Certain disadvantaged individuals are allowed a credit for wages received from an EZ business. Public employees are not eligible for the credit. The amount of the credit is 5 percent 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 EZ, computed as though that income represented the taxpayer's entire taxable income.

### **Apportioning**

For businesses operating inside and outside an EZ, the amount of credit that may be claimed is limited by the amount of tax on income attributable to the EZ. Income is first apportioned to California using the same formula as that used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor for taxable years beginning on or after January 1, 2011, certain corporations may elect to use a single factor, 100 percent sales apportionment formula). This income is further apportioned to the EZ using a two-factor formula based on the property and payroll of the business.

Attachment B

AB 1657

As Introduced January 15, 2010

BILL NUMBER: AB 356  
VETOED DATE: 09/23/2000

SEP 23 2000

To the Members of the Assembly:

I am returning Assembly Bill 356 without my signature.

This bill would require the Trade and Commerce Agency to designate a geographical area within one city in Los Angeles County as a new enterprise zone.

In order to maximize the effectiveness of economic development zones, I believe that the number of zones must be limited and the areas chosen on a statewide, competitive basis. This bill, however, bypasses that process and would establish a new enterprise zone - without the traditional statewide, competitive process.

To help economically stressed communities like the intended beneficiary of AB 356, I have signed SB 511, which allows the Trade and Commerce Agency to award bonus points based on economic need but maintains the competitive process for the creation of future enterprise zones.

Sincerely,

GRAY DAVIS