Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Caballero	Analyst:	Jahna Alvarado	Bill Number:	AB 2044
Related Bills:	See Legislative History	Telephone:	845-5683	Amended Date:	April 5, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Enterprise Zone Credits/Limit Aggregate Amount Of Credits Allocated Any Fiscal Year To $250 Million Per Fiscal Year Beginning 2010-11

SUMMARY

This bill would modify the definition of qualified wages for purposes of the enterprise zone (EZ) hiring credit and would establish a maximum aggregate EZ credit amount that could be allocated each fiscal year.

SUMMARY OF AMENDMENTS

The April 5 2010, amendments replaced the bill language as introduced on February 17, 2010, with the provisions related to EZ credits discussed in this analysis.

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

PURPOSE OF THE BILL

It appears that the purpose of this bill is to place a $250 million limit on the total EZ credits that could be allowed for a fiscal year.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2010.

POSITION

Pending.

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.

Board Position:			Department Director	Date
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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 EZ. Using specified criteria, the Department of Housing and Community Development (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 DHCD is authorized to designate 42 EZs under current law (42 currently are designated). When an EZ expires, DHCD is authorized to designate another in its place to maintain a total of 42 EZs. 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.

Under the Revenue and Taxation Code (R&TC), existing state law provides special tax credits for taxpayers conducting business activities within an EZ. The EZ credits available to businesses are the sales or use tax credit and the hiring credit. In addition, specified employees of businesses operating in an EZ may claim a wage credit.

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 EZ income. 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.

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 EZ, 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.

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. EZ income is first apportioned to California using the same formula used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor). This income is then further apportioned to the EZ using a two-factor formula based on the property and payroll of the 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.

Assignment of Credits (Applicable To Corporate Tax Law (CTL) Only)

Current law allows the assignment of certain credits, including the EZ, to taxpayers subject to the CTL that are members of a combined reporting group and includes the following provisions:

- Provides that an "eligible credit" may be assigned by a taxpayer to an "eligible assignee."
- "Eligible credit" means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008.
- "Eligible assignee" means any "affiliated corporation" that is properly treated as a member of the same combined reporting group.
- "Affiliated corporation" means a corporation that is a member of a commonly controlled group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.
- Gives the Franchise Tax Board (FTB) authority to issue rules, procedures, guidelines, and regulations necessary to implement.

Although current law is silent on a specified aggregated total of EZ credits that may be claimed, current law limits the EZ credits a taxpayer may use to reduce their tax liability to the amount of tax attributable to the taxpayer's EZ income. Thus the maximum EZ credit amount that could be claimed for a taxable year is effectively limited to the aggregate amount of tax due for the year on all income generated by the trades and businesses operating within the EZs.

THIS BILL

This bill would modify the definition of qualified wages by increasing the maximum amount paid to a qualified employee that would be subject to the credit from 150 percent to 250 percent of the minimum wage.[1] The resulting increase would be from $12 per hour to $20 per hour.

This bill would, beginning with fiscal year 2010-11, limit the aggregate amount of EZ income and franchise tax credits that could be allocated to $250 million per fiscal year.

This bill would require the department to prescribe rules, guidelines, or procedures necessary or appropriate to administer the fiscal year allocation.

IMPLEMENTATION CONSIDERATIONS

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

The bill lacks administrative details necessary to implement the bill and determine its impacts to the department's systems, forms, and processes. For example, this bill is silent on the following:

- What agency is responsible for administering the allocation?
- What method would be used to make the allocation?
- How would the allocation cap be allocated, tracked, and monitored?
- How and when would a taxpayer request, and receive notification of, an allocation?
- When would an allocation occur in relation to incurring an expense or receiving wages?
- When would an allocation occur in relation to the filing of a tax return claiming a credit subject to the allocation?
- How would disallowance of the credit due to the cumulative total of the credit being reached be treated?
- Would an underpayment resulting from a credit in excess of the cap being disallowed be subject to an underpayment penalty? Interest?
- Would a reallocation of any unallocated amount or unused allocated amount for a fiscal year be allowed?
- Would the department be required to provide any information on the allocation via its Web site?

It is recommended that the bill specify the administrative conditions to resolve any confusion as to the author's intentions.

[1] California's minimum wage was increased to $8 per hour effective January 1, 2008.

Because the bill does not provide an exception to the Administrative Procedures Act requirements, the operative date specified in the bill does not provide adequate time for the FTB to adopt regulations on the components of administering the allocation this bill would establish. It is recommended that the operative date be revised to provide adequate time to complete the regulatory process.

This bill would limit EZ credits to a maximum allocation of $250 million per fiscal year. Based on departmental data, approximately $480 million in EZ credits were used to reduce tax for the taxable year 2007. This data indicates that the cap would be met and excess credits would be denied beginning with the initial allocation period. Because this bill is silent on the treatment of credits denied because the fiscal year allocation cap was met, a taxpayer could file an amended return claiming a refund of the denied credit when the subsequent fiscal year's cap becomes available for allocation. This could significantly increase the compliance burden on taxpayers and administrative costs for the department.

Two of the three available EZ credits (the credit for sales and use tax and the hiring credit) are allowed to taxpayers engaged in a trade or business within an EZ. The remaining EZ credit is allowed to certain employees that receive wages for their work within an EZ. This bill would establish a fiscal year limitation that would apply to all three of the EZ credits. If it is the author's intention to place a fiscal year limit for the credits allowed to trades and businesses operating within an EZ, this bill should be amended to remove the employee's credit for EZ wages from the limit that this bill would establish.

TECHNICAL CONSIDERATIONS

This bill would move existing operative date language to a new subdivision. As a result, the changes this bill would make would be applicable retrospectively. Attached amendments would correct this concern.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida allows several incentive provisions to encourage businesses in the revitalization of enterprise zones. The Florida Enterprise Zone Act and various tax incentive provisions are set to expire on December 31, 2015.

Illinois has 95 enterprise zones, *Massachusetts* has an Economic Development Incentive Program*, Michigan* has in excess of 150 geographic areas designated as Renaissance Zones, *Minnesota* has 5 zone-based tax incentive programs, and *New York* has 85 Empire Zones.

Each of these states' designated zone programs do not appear to have a maximum allocation limit on the amount of credits that may be claimed. The states were reviewed due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

This bill would limit EZ credits to a maximum allocation of $250 million per fiscal year beginning with fiscal year 2010-2011. Because the bill is silent on the administration of the allocated cap, the department's costs to administer this bill are unable to be determined until implementation concerns have been resolved. As the bill continues to move through the legislative process and implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Because this bill is silent on how the aggregate amount of $250 million in EZ credits would be allocated by fiscal year and the interaction between the allocation of the credit by fiscal year and the allowance of the credit by taxable year, we are unable to determine the revenue impact of this bill.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2044
AS AMENDED APRIL 5, 2010

AMENDMENT 1

On page 5, line 7 and 8, strikeout "the act adding this subdivision" and insert:

Chapter 323 of the Statutes of 1998

AMENDMENT 2

On page 13, line 34 and 35, strikeout "the act adding this subdivision" and insert:

Chapter 609 of the Statutes of 1997

AMENDMENT 3

On page 17, line 21 and 22, strikeout "the act adding this subdivision" and insert:

Chapter 323 of the Statutes of 1998

AMENDMENT 4

On page 26, line 21 and 22, strikeout "the act adding this subdivision" and insert:

Chapter 609 of the Statutes of 1997