Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Buchanan	Analyst:	Jahna Alvarado	Bill Number:	AB 2428
Related Bills:	See Legislative History	Telephone:	845-5683	Amended Date:	April 8, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Green Technology Zone Pilot Program Act

SUMMARY

Under uncodified law, this bill would establish two tax credits for taxpayers subject to tax under the Personal Income Tax Law (PITL) under the Green Technology Zone Pilot Program Act (the Act).

This bill would make a number of other changes under the Act. These changes do not affect the department and are not discussed in this analysis.

SUMMARY OF AMENDMENTS

The April 8, 2010, amendments replaced the bill language as introduced on February 19, 2010, with the provisions discussed in this analysis.

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

PURPOSE OF THE BILL

According to the legislative findings and declarations in the bill, the purpose of the bill is to create new permanent jobs in California, and promote economic development and environmental protection by establishing a green technology pilot program in designated geographical areas.

EFFECTIVE/OPERATIVE DATE

Assuming enactment before October 1, 2010, this bill would become effective on January 1, 2011, and operative for taxable years beginning on or after that date.

POSITION

Pending.

Summary of Suggested Amendments

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

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Selvi Stanislaus	06/03/10
____ N	____ OUA	__X__ 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.

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 provides for the designation of enterprise zones (EZs), Local Agency Military Base Recovery Areas (LAMBRAs), a Targeted Tax Area (TTA), and two Manufacturing Enhancement Areas (MEAs). Using specified criteria, the Department of Housing and Community Development (DHCD) designates these economic development areas 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). However, when an EZ expires, the DHCD is authorized to designate another in its place. Eight LAMBRA designations are authorized, at least one from each of the five regions (as specified) of the state (8 are currently designated). Each LAMBRA designation is binding for eight years. The TTA was designated November 1, 1998, and the MEAs were designated October 1, 1998. Both the TTA and MEAs are binding for 15 years beginning January 1, 1998.

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. Once an EZ is dedesignated, it is no longer an EZ for designation purposes. Thus, once 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, existing state law provides special tax incentives for taxpayers conducting business activities within economic development areas. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within the economic development areas and a tax credit for employees working in an enterprise zone. Additional details on the tax incentives can be found in Attachment A.

THIS BILL

This bill would establish a 10-year Green Technology Zone Pilot Program (Pilot Program). Participation in the Pilot Program would be limited to the Cities of Elk Grove and Livermore.

Under uncodified law, this bill would allow a credit for the sales and use tax paid to purchase qualified property and would also allow a credit for qualified wages paid to qualified employees for taxpayers conducting a trade or business within a green technology zone. These credits would be allowed as credits against the “net tax”, as defined in Revenue and Taxation Code (R&TC) section 17039.

Under the terms of this bill, the sales and use tax included in the credit base would be excluded from the qualified property’s depreciable basis.

The wage credit would be calculated as the sum of the following:

- 50 percent of qualified wages paid in the first year of employment,
- 40 percent of qualified wages paid in the second year of employment,
- 30 percent of qualified wages paid in the third year of employment,
- 20 percent of qualified wages paid in the fourth year of employment, and
- 10 percent of qualified wages paid in the fifth year of employment.

The credit would be calculated as the sum of the sales and use tax credit and the credit for qualified wages paid to qualified employees that this bill would allow, plus the EZ hiring credit, if any. The credit that could reduce tax would be limited to the tax due on the income attributable to the green technology zone determined as if that attributable income represented all of the income of the taxpayer subject to tax under the PITL.

This bill would define a number of terms and phrases, including, “eligible area,” “green technology zone,” governing body,” “qualified employee,” “qualified property,” and “qualified wages.”

IMPLEMENTATION CONSIDERATIONS

Department staff have identified the following implementation considerations. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified as the bill moves through the legislative process.

The form of this bill is unprecedented in that the provisions are uncodified. As a result, provisions of existing PITL, Corporate Tax Law (CTL) and related laws that define various terms and provide rules for the administration of tax credits under the PITL and the CTL are not available to administer the credits proposed by this bill. For example, the bill uses the terms "taxpayer" and "taxable year;" however, the bill fails to define the terms. In addition, rules under existing codified law concerning the application of credits would not be applicable to the credits under the bill. Providing the substantative provisions of a tax credit in uncodified law appears to conflict with longstanding practices of the Legislature. Uncodified law creates many uncertainties normally resolved by existing codified law, which could lead to disputes with taxpayers and greatly complicate implementation of this bill.

The bill lacks administrative details that must be determined 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 is the designation period for a green technology zone?
- Could a designated green technology zone be de-designated? By whom?
- How would a taxpayer that has operations both within and outside of a green technology zone determine their green technology zone "attributable income?"
- Would unused credits be eligible to be carried forward if they are limited by the "net tax"?
- Would generation of credits be limited to the 10 year pilot program?
- Would there be a maximum amount of "qualified purchases" that would be eligible for the sales and use tax credit?
- What are the measurement criteria for purposes of determining whether property is "qualified property?"
- How would seasonal employees be treated for purposes of the wage credit?
- Would the wage credit be reduced by other credits that could be allowed for the same wages?
- Where would this credit appear in the ordering of available credits?
- Would the pilot program be evaluated at the end of the 10 year pilot period? By whom?
- Who would be responsible for any data capturing or reporting requirements?

It is recommended that this bill be amended to clearly and consistently express the author's intent.

TECHNICAL CONSIDERATIONS

The approach of providing substantative provisions of a tax credit in uncodified law appears to conflict with longstanding practices of the Legislature. It is recommended that this bill be amended to correct what appears to be an error.

LEGISLATIVE HISTORY

AB 1159 (Perez, 2009/2010) would have established a tax credit equal to 100 percent of the sales or use tax paid to acquire property used in an EZ, TTA, or a LAMBRA to produce or generate renewable energy. AB 1159 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 1527 (Arambula, 2007/2008) would have, among other things, established a tax credit equal to 8 percent of the qualified costs for qualified cleantech property placed in service in California. AB 1527 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

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 a renewable energy technologies investment tax credit equal to 75 percent of all eligible capital costs, operation and maintenance costs, and research and development costs incurred between July 1, 2006, and June 30, 2010. Taxpayers must apply to the Florida Energy and Climate Commission to be eligible for this credit.

No similar laws were found for *Illinois, Massachusetts, Michigan, Minnesota*, and *New York.*

FISCAL IMPACT

This bill would establish two uncodified personal income tax credits under the Green Technology Zone Pilot Program Act. As a result of the uncodified language, 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

<u>Revenue Estimate</u>

The revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 2428 As Amended April 8, 2010 Effective For Taxable Years Beginning On or After January 1, 2011 Assumed Enactment By September 30, 2010 ($ in Millions)		
2011-12	2012-13	2013-14
-$0.6	-$3.1	-$6.2

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

LEGISLATIVE STAFF CONTACT

Legislative Analyst
Jahna Alvarado
(916) 845-5683
jahna.alvarado@ftb.ca.gov

Revenue Manager
Monica Trefz
(916) 845-4002
monica.trefz@ftb.ca.gov

Asst. Legislative Director
Patrice Gau-Johnson
(916) 845-5521
patrice.gau-johnson@ftb.ca.gov

Attachment A
AB 2428
As Amended April 8, 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 economic development area (except a Manufacturing Enhancement Area). The amount of the credit is limited to the tax attributable to economic development area income. Qualified property is defined as follows:

Enterprise Zone 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.

LAMBRA:

- high-technology equipment (e.g., computers);
- aircraft maintenance equipment;
- aircraft components; or
- certain depreciable property.

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

Hiring Credit

A business located in an economic development area 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 economic development area 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 economic development area and at least 50 percent must be performed inside the economic development area. The business may claim up to 50 percent of the wages paid to a qualified employee as a credit against tax imposed on economic development area income.

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 economic development area (except an MEA) 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. For LAMBRA businesses, the amount of the deduction is added back to the taxpayer's income if at the close of the second year the taxpayer does not have a net increase of one or more jobs (defined as 2,000 paid hours per employee per year). The property's basis must be reduced by the amount of the deduction. For enterprise zones, LAMBRAs, and the TTA 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 economic development area may elect to carry over 100 percent of the economic development area net operating losses (NOLs) to deduct from economic development area 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 economic development area.

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. This incentive is not available for LAMBRAs, the TTA, or MEAs.

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 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 enterprise zone, computed as though that income represented the taxpayer's entire taxable income. This incentive is not available for LAMBRAs, the TTA, or MEAs.

Apportioning

For businesses operating inside and outside an economic development area, the amount of credit that may be claimed is limited by the amount of tax on income attributable to the economic development area. 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 economic development area using a two-factor formula based on the property and payroll of the business.