

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Corbett Analyst: Jahna Alvarado Bill Number: SB 483

Related Bills: See Legislative History Telephone: 845-5683 Amended Date: August 20, 2009

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Enterprise Zone/City of Fremont

SUMMARY

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

SUMMARY OF AMENDMENTS

The August 20, 2009, amendments replaced the language as amended on July 6, 2009, with the proposed EZ designation.

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

PURPOSE OF THE BILL

The urgency language indicates that the purpose of this bill is to "encourage economic development and stability by allowing the creation of an enterprise zone within the City of Fremont as quickly as possible."

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

POSITION

Pending.

SUMMARY OF SUGGESTED AMENDMENTS

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

Board Position:

_____ S _____ NA _____ NP
_____ SA _____ O _____ NAR
_____ N _____ OUA _____ X PENDING

Department Director

Date

Selvi Stanislaus

09/01/09

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 DHCD is authorized to designate 42 EZs under current law (42 are currently 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.

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, 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 Fremont City Council, to designate one EZ within the geographic area of the City of Fremont.

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.

This bill fails to specify the earliest date the EZ could be designated. If this bill becomes operative for an affected taxpayer's 2009 taxable year, the limitation on allowable business credits for that taxable year would apply. If it is the author's intent to exclude from the business credit limitation the 2009 EZ credits authorized by this bill, this bill should be amended.

LEGISLATIVE HISTORY

SB 830 (Wright, et al., 2009/2010) would authorize the Governor to issue an executive order designating an automobile manufacturing plant located in Fremont, California as an EZ. SB 830 is currently in the Assembly Appropriations Committee.

SBX4 32 (Corbett, 2009/2010) would have required 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. The EZ designation language in SBX4 32 is identical to this bill's language. SBX4 32 failed to pass prior to the adjournment of the fourth special session of 2009/2010.

AB 1452 (Committee on Budget, Stats. 2008, Ch. 763) limited the allowable business tax credit for a taxpayer with "net business income" (PITL) or income subject to tax (CTL) equal to or greater than \$500,000 to a specified amount. The limitation applies to taxable years beginning on or after January 1, 2008, and before January 1, 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 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.

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.

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.

SB 200 (Kelley, Stats. 1997, Ch. 609) made various technical changes to the credits allowed under the Enterprise Zone Act, and AB 2798 (Machado, Stats. 1998, Ch. 323) clarified the EZ incentive calculation for apportioning corporations.

SB 2023 (Costa, Stats. 1996, Ch. 955), the Enterprise Zone Act, among other things, allowed a credit for sales and use tax paid by a taxpayer for qualified property placed into service in a California EZ.

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

This revenue loss from this bill would be:

Estimated Revenue Impact of SB 483 as Amended 8/20/09 EZ Credits – City of Fremont Effective Taxable Years BOA 1/1/09 Enactment Assumed September 2009 (\$ in Millions)		
2009-10	2010-11	2011-12
-\$5	-\$15	-\$16

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

Revenue Discussion

The revenue impact of this bill would largely depend on the number of businesses that would purchase qualifying property subject to the sales or use tax, the amount of wages paid to qualifying employees, and the amount of credits that would be applied to reduce income tax liabilities.

Based on departmental data, the revenue loss for the existing 42 designated EZs was approximately \$430 million for taxable year 2007, an average of approximately \$10 million dollars per zone, ($\$430 \text{ million} / 42 \approx \10 million). Assuming a 5 percent annual growth rate in credit utilization, the potential EZ credit utilization for tax year 2009 is approximately \$11.3 million per zone, [$\$10 \text{ million} + (\$10 \text{ million} \times 5\%) + (\$10 \text{ million} \times 5\% \times 105\%) \approx \11.3 million].

Because Fremont is an urban area with major business operations, it is assumed for purposes of this estimate that the average EZ credit for the new zone would be 20 percent greater than the state-wide average resulting in an estimated revenue loss of \$13.5 million for taxable year 2009, [$\$11.3 \text{ million} + (\$11.3 \text{ million} \times 20\%) \approx \13.5 million].

Because this bill would be effective and operative upon enactment, it is assumed that the new EZ would be designated by 10/1/2009, allowing businesses in the zone to claim credits for 25 percent, three of twelve months, of the 2009 taxable year. Therefore, the revenue loss for the 2009 taxable year, the initial taxable year this credit would be allowed, would be reduced by 75 percent, resulting in a revenue loss of approximately \$3 million ($\$13.5 \text{ million} \times 25\% \approx \3 million).

Taxable year estimates are converted to fiscal year cash-flow estimates as shown in the table above. For example, the 2009 -10 cash flow estimate of approximately \$5 million consists of \$3.5 million for the 2009 taxable year and \$1.5 million in reduced estimated payments for the 2010 taxable year.

POLICY CONCERNS

Generally EZ designation is awarded based on a competitive application process. This bill would require 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

SB 483
As Amended August 20, 2009

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

SB 483
As Amended August 20, 2009

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