ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Wright, et al.	Analyst:	Jahna Alvarado	Bill Number:	SB 830
Related Bills:	See Legislative History	Telephone:	845-5683	Amended Date:	July 24, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Enterprise Zone/Fremont Automobile Manufacturer/State Agencies Must Give Preference If Procuring For Automobile Or Trucks To Those Manufactured In Enterprise Zone

SUMMARY

Under the Government Code, this bill would authorize the Governor to designate a facility in Fremont, California as an enterprise zone.

SUMMARY OF AMENDMENTS

The July 24, 2009, amendments replaced the language as introduced on March 19, 2009, with the proposed enterprise zone (EZ) designation and other specified incentives.

This bill would also make changes to the Public Utilities Code, the Unemployment Insurance Code, and the Sales and Use Tax Law. These changes do not affect the department and are not discussed in this analysis.

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

PURPOSE OF THE BILL

The legislative intent language indicates that the purpose of this bill is to, "urge the Governor to immediately engage in talks with the NUMMI plant and to prepare beneficial financial incentives to offer the company as part of any agreement to retain the NUMMI plant in California."

EFFECTIVE/OPERATIVE DATE

If enacted in the first year of the two-year session, this bill would be effective January 1, 2010, and operative on or after that date.

POSITION

Pending.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Lisa Crowe	08/25/09
_______ N	_______ OUA	___X___ PENDING	for Selvi Stanislaus	

SUMMARY OF SUGGESTED AMENDMENTS

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

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.

<u>FEDERAL LAW</u>

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

<u>STATE LAW</u>

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 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 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. Once an EZ is dedesignated, it is no longer an EZ for designation purposes. Thus, once 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, among other things, authorize the Governor to issue an executive order designating an automobile manufacturing plant located in Fremont as an EZ. A taxpayer operating within the designated EZ would be eligible for existing credits allowed under the R&TC.

IMPLEMENTATION CONSIDERATIONS

The EZ hiring credit and sales and use tax credit under the Personal Income Tax Law and Corporation Tax Law are allowable for 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 hires or acquisitions as of a specific date that is not the zone designation date, this bill should be amended.

This bill would allow the Governor to issue an executive order designating "a facility that manufactures automobiles" as an EZ. Taxpayers engaged in businesses other than automobile manufacturing, ex: cafeteria, child-care, financial institution branch, that operate within the specified facility would be eligible for the EZ incentives. If the author's intent is to allow EZ incentives only for taxpayers engaged in automobile manufacturing, the author may wish to amend this bill.

This bill is silent as to the volume of automobile manufacturing required to maintain the EZ designation. It is possible that the automobile manufacturing activity could decline over time. If it is the author's intent to provide an incentive to maintain existing production levels or expand automobile manufacturing in the designated facility to 100 percent of the facility's capacity, the author may wish to amend this bill.

This bill would allow the Governor to waive any requirements for the designation of the specified facility as an EZ by executive order. If the requirement to submit an application for zone designation is waived, it is unclear how a zone administrator would be identified. The absence of a clear identification of the zone administrator could lead to disputes with taxpayers and would complicate the administration of the EZ credits attributable to the newly designated EZ.

LEGISLATIVE HISTORY

SBX4 32 (Corbett, 2009/2010) would require 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. 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 888 (Dunn, 2001/2002) would have required the 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, L.O.F., 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

<u>Revenue Discussion</u>

FTB disclosure rules prohibit the presentation of an estimated revenue impact for this bill because the number of affected taxpayers is too small. However, data available from the legislative findings have been used to illustrate the potential revenue impact.

For purposes of this discussion, it is assumed that the EZ income tax credits would be allowed only to the automobile manufacturer operating within the EZ. Vendors or businesses operating within the proposed EZ whose trade or business is not automobile manufacturing would be ineligible for the EZ credits.

This bill's legislative findings indicate that there would be approximately 4,700 workers employed in the proposed EZ. Assuming an annual turnover rate of approximately 5 percent of the existing workforce and assuming that all new hires are qualified employees, there would be approximately 235 new zone hiring credits per year, (4,700 x 5% = 235). Assuming each qualifying employee works 2,000 hours each year, the maximum wage eligible for the credit would be $24,000, (($8/hour x 150%) x 2000 = $24,000). Because the credit would be 50 percent of the first year's qualifying wages, 235 qualified employees could generate as much as $2.8 million in hiring credits in their first year of employment, (($24,000 x 50%) x 235 ≈ $2.8 million). Assuming the employees remain eligible for the hiring credit for the entire five-year credit period, the total hiring credit could be as much as approximately $8.5 million.[1]

EZ incentives include an income tax credit for sales and use tax on the purchase of up to $20 million per year in qualified investments. For purposes of this discussion it is assumed that 85 percent of the maximum annual expenditure of $20 million qualifies for the sales and use tax credit. Because the sales and use tax rate in the proposed location is currently 9.75 percent, the maximum annual qualifying investment of $20 million would generate an annual credit of approximately $1.7 million, (($20 million x 85%) x 9.75% ≈ $1.7 million). Thus, the total credits generated by the proposed EZ could be as much as approximately $4.5 million in the first year, ($2.8 million hiring credit + $1.7 million sales and use tax credit = $4.5 million), growing to approximately $10 million per year by year five (because hiring credits may be claimed for 5 years from the date of hire).

The actual utilization of the credits generated would depend on the specific tax attributes of the qualified taxpayers in the zone. Assuming the new zone is designated in January 2010, approximately 25 percent of the credits utilized in the first year would reduce fiscal year (FY) 2009/10 revenues, and the remainder would reduce FY 2010/11 revenues.

[1] R&TC sections 17053.74 and 23622.7 limit the maximum wage eligible for the EZ hiring credit to $12/hour,150% of the California minimum wage of $8/hour. This discussion assumes that each eligible new hire represents 2000 hours of employment per year and the minimum wage remains at $8/hour. Based on these assumptions, the maximum EZ hiring credit is calculated as follows:

	A Credit %	B Max. Credit/hr	C B x 2000	C x 235
1st 12 months	50%	$6.00	$12,000.00	$2,820,000
2nd 12 months	40%	$4.80	$9,600.00	$2,256,000
3rd 12 months	30%	$3.60	$7,200.00	$1,692,000
4th 12 months	20%	$2.40	$4,800.00	$1,128,000
5th 12 months	10%	$1.20	$2,400.00	$564,000
Maximum Credit				$8,460,000

POLICY CONCERNS

Generally EZ designation is awarded based on a competitive application process that includes a zone applicant's plan for "effective, innovative, and comprehensive regulatory, tax, program, and other incentives in attracting private sector investment to the enterprise zone." This bill would allow the designation of an EZ via executive order, which is unprecedented.

LEGISLATIVE STAFF CONTACT

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Attachment A

SB 830
As Amended July 24, 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% 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 830
As Amended July 24, 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