

Franchise Tax Board

**ANALYSIS OF ORIGINAL BILL**

Author: Perez, et al. Analyst: Jahna Alvarado Bill Number: ABX1 11

Related Bills: See Legislative History Telephone: 845-5683 Introduced Date: February 2, 2011

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Enterprise Zones/ Targeted Employment Areas

**SUMMARY**

This bill would modify the Enterprise Zone (EZ) hiring credit.

Under the Government Code, this bill would modify the definition of a Targeted Employment Area (TEA) and the process to obtain and retain a TEA designation.

**RECOMMENDATION AND SUPPORTING ARGUMENTS**

No position.

**Summary of Suggested Amendments**

Technical amendments are suggested to clarify a phrase and to add specific cross references.

**PURPOSE OF THE BILL**

According to the bill's language, the purpose of the bill is to address the fiscal emergency declared and reaffirmed by Governor Jerry Brown by proclamation on January 20, 2011.

**EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2011.

**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:	Executive Officer	Date
_____ S		
_____ SA	Anne Maitland	11/3/11
_____ N	for Selvi Stanislaus	
_____ NA		
_____ O		
_____ OUA		
___ X ___ NP		
_____ NAR		

## FEDERAL/STATE LAW

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

Under current federal law, the work opportunity tax credit (WOTC) is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

California does not conform to the federal work opportunity credit; however, the following California hiring credits are reduced by the amount of the federal work opportunity credit: (1) the EZ credit; (2) the manufacturing enhancement area (MEA) credit; and (3) the Local Agency Base Recovery Area (LAMBRA) credit. Because California conforms to Internal Revenue Code (IRC) section 51 as of the specified date of January 1, 2009, there is no IRC section 51 reduction to the specified hiring credits with respect to federal work opportunity credits allowed for individuals hired after August 31, 2011.

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 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 currently are 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.

Under the Government Code, a TEA is used to encourage businesses in an EZ to hire eligible residents of certain geographic areas within a city, county, or city and county. A TEA may be, but is not required to be, the same as all or part of an EZ. TEAs are limited to census tracts where 51 percent or more of the individuals are of low or moderate income. TEAs are drawn using census data at the time of the EZ's formation.

Under existing law, each local governmental entity that has jurisdiction over an EZ must, within 180 days of updated U.S. census data becoming available, approve by resolution or ordinance the boundaries of the TEA reflecting the new census data. With the exception of a TEA whose boundaries are unchanged, written notification of the approval must be provided to the DHCD.

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, specified employees of businesses operating in an EZ may claim a wage credit.

### 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. A taxpayer located in an EZ is allowed a credit of up to 50 percent of wages paid to "qualified employees" in the first year, decreasing by 10 percent each year thereafter. The taxpayer is required to obtain a voucher certificate for each of its "qualified employees." The voucher certificates are issued by the Employment Development Department (EDD) or the local (within the same EZ as the workplace of the employee) agency familiar with the public assistance statutes.

Currently, EDD and the local entities that administer the Workforce Investment Act and CalWorks have the authority to issue the voucher certificates. The voucher certificate indicates that the employee is qualified for or receiving any of the specified forms of public assistance and thus is a "qualified employee" for purposes of the hiring credit. Taxpayers that claim the hiring credit are asked to retain a copy of the voucher certificate for each of its "qualified employees." Upon the request of FTB, the taxpayer is required to provide the voucher certificate for purposes of verifying the hiring credit claimed by the taxpayer.

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<sup>1</sup>). This income is further apportioned to the EZ using a two-factor formula based on the property and payroll of the business.

### THIS BILL

Under the Government Code this bill would do all of the following:

- Modify the definition of TEA by requiring that the most recent US Department of Census Bureau data available at the time the TEA is designated be used to determine the census tracts eligible for inclusion in the TEA.

---

<sup>1</sup> ABX3 15 (Krekorian, Stats. 2009, Ch. 09X3-10)

- Modify the process of obtaining and retaining TEA designation by requiring:
  - The TEA designation to be based on data from the most current household income data published by the US Census Bureau at the time the TEA is designated or modified.
  - A TEA's boundaries to be reviewed upon the release by the US Census Bureau's five-year American Community Survey, and to the extent necessary, the boundaries shall be updated via resolution by the local governmental entity to reflect the new household income data.
  - The local governmental entity to provide a copy of the resolution updating the TEA boundaries or a letter stating that a boundary change is unnecessary to the DHCD within 180 days of the release of new household data or the TEA designation would be invalidated for a period of two years.
  - The DHCD to provide notice of a TEA invalidation as specified to the FTB and the local EZ administrator.

Under the terms of this bill, a business that had previously received certification that an employee was a resident of a TEA would be exempted from the invalidation period. The vouchering exemption would be nontransferable to another business.

This bill would modify the EZ hiring credit by doing all of the following:

- Modify the definition of "qualified wages" applicable to taxpayers in the Long Beach EZ that are engaged in aircraft manufacturing by replacing references to the four digit Standard Industrial Classification (SIC) Manual codes with references to three digit codes contained in the 2007 edition of the North American Industry Classification System (NAICS).
- Modify the definition of "qualified employee" by doing all of the following:
  - Replacing references to obsolete federal and state programs with references to the current programs.
  - Specifying that the maximum wage that a resident of a TEA could receive would be limited to the moderate-income amount for a family of four based on the countywide average household income.
  - Eliminating members of a targeted group as defined in IRC section 51 from the definition of "qualified employee," and adding persons eligible for or a recipient of the credit under IRC section 51 to the definition of "qualified employee."

### 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.

It is unclear how, in what circumstances, and to whom the exception from the TEA invalidation would apply. For example, this bill would provide an exemption from the invalidation to a business that had previously received certification of an employee. Because the bill fails to specify the basis for the previous certification, would the business continue to be eligible to obtain certifications based on an employee's residence within the boundaries of the invalidated TEA

regardless of the basis for the previous certification? Further, it appears that this exception contradicts, and is more advantageous than, the provision that would continue to allow certifications based on residence within the invalidated TEA to businesses that had previously received a certification based on TEA residence. In order to provide clarity for taxpayers, employees, zone administrators, and state and local governmental entities, this bill should be amended.

This bill uses phrases that are undefined, i.e., “countywide average household income” and “moderate income for a family of four.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

Because the NAICS uses a six digit code to identify the industry segment that a four digit SIC code identifies, substituting a truncated three digit NAICS code for the SIC code could expand eligibility for the larger EZ hiring credit amount allowed for certain qualified taxpayers in the Long Beach EZ. If this is contrary to the author’s intention, this bill should be amended.

This bill would establish a category of qualified employees that are persons eligible for or recipients of the Federal WOTC under IRC section 51, and would eliminate the existing category that is based on being a member of a targeted group as defined in IRC section 51. Because it is employers that are eligible for or receive the WOTC, this change would create a category of “qualified employees” composed of employers that would be inconsistent with the remaining categories of “qualified employees.” For clarity of language, and internal consistency within the EZ hiring credit, it is recommended that this bill be amended.

Because this bill fails to specify otherwise, the reference to IRC section 51 would be as it existed on California’s general conformity date of January 1, 2009. As a result, amendments to IRC section 51 made after January 1, 2009, would be inapplicable for California purposes. For example, there is no IRC section 51 reduction to the specified hiring credits with respect to federal work opportunity credits allowed for individuals hired after August 31, 2011. If this is contrary to the author’s intention, this bill should be amended to refer to IRC section 51 as applicable for federal income tax purposes for the taxable year.

### TECHNICAL CONSIDERATIONS

Amendments 1 through 9, 11, and 13 would increase clarity by making grammatical changes and providing for consistent use of terminology.

Amendments 10 and 12 would increase clarity by adding a specific cross reference to the existing language.

### **LEGISLATIVE HISTORY**

AB 231 (Perez, et al., 2011/2012) would make a number of changes to the existing GTEDA tax credits, including revising the calculation of the amount of the hiring credit and requiring that a taxpayer complete a registration process prior to being eligible for GTEDA tax credits. AB 231 failed to pass out of the Assembly Committee on Jobs, Economic Development, and the Economy prior to the end of the legislative session.

AB 232 (Perez, et al., 2011/2012) would, among a number of other changes to the administrative requirements of the EZ act, require state entities to: (1) affirmatively support their statutory responsibilities under the Enterprise Zone Act, and, within their statutory responsibility, to respond to requests made by and on the behalf of an EZ, and (2) consider how the G-TEDA programs could be integrated into workforce development and training plans and strategies in order to maximize the benefits to workers and businesses. These requirements are identical to provisions of this bill. AB 232 failed to pass out of the Assembly Committee on Jobs, Economic Development, and the Economy prior to the end of the legislative session.

AB 1411 (Perez, et al., 2011/2012) would make a number of changes to the EZ program, including placing a limit on the size of a proposed EZ in specified circumstances, specifying state agencies' responsibilities under the EZ Act, and expanding the data that the FTB is required to report to the Legislature and the DHCD. AB 1411 failed to pass out of the Senate Appropriations Committee prior to the end of the legislative session.

SB 301 (DeSaulnier, 2011/2012) would, for applications for EZ designation that are submitted on or after January 1, 2012, limit the size of a proposed EZ when the proposed EZ's boundaries overlap the boundaries of one or more existing or expired EZs (previously designated EZs). SB 301 failed to pass out of the Assembly Committee on Jobs, Economic Development, and the Economy prior to the end of the legislative session.

## **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 businesses located in an EZ a tax credit based on wages paid to new employees. Other wage-based tax credits are offered to businesses that are located in high crime areas or in rural areas. Employers may earn job tax credits if hired employees reside in the designated EZ or a rural county. Up to 45 percent of an employee's wages may be claimed as a job tax credit. A business that files an amended return is not allowed any credit or carryforward in excess of the amount claimed on its original return for the tax year. 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; *New York* has 72 Empire Zones. *New York's* Empire Zone program sunset as of June 30, 2010. Businesses certified in the program prior to the sunset date remain in the program, and continue to be eligible for all the Empire Zone benefits, for the rest of their benefit period as long as they remain in compliance with the law and Empire Zone regulations. None of these states offer a wage credit similar to California's EZ hiring credit.

## **FISCAL IMPACT**

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

## **ECONOMIC IMPACT**

This bill would, for applications for EZ designation submitted on or after January 1, 2011, limit the size of the proposed EZ in certain circumstances. Because it is impractical to predict future EZ boundaries, and whether the limitation would apply to any or all of the EZs proposed in the future, the potential impact of this bill is unable to be determined, but would be expected to generate a modest increase in General Fund revenues.

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

## **SUPPORT/OPPOSITION**

Support: None provided to the FTB.

Opposition: None provided to the FTB.

## **ARGUMENTS**

Pro: Proponents may argue that EZ program reform is necessary to refocus the program's incentives for maximum benefit to the state's economy.

Con: Opponents may argue that modifying the EZ program during an economic downturn could inadvertently delay early recovery efforts.

## **LEGISLATIVE STAFF CONTACT**

Jahna Alvarado

Legislative Analyst, FTB

(916) 845-5683

[jahna.alvarado@ftb.ca.gov](mailto:jahna.alvarado@ftb.ca.gov)

Patrice Gau-Johnson

Asst. Legislative Director, FTB

(916) 845-5521

[patrice.gau-johnson@ftb.ca.gov](mailto:patrice.gau-johnson@ftb.ca.gov)

Analyst	Jahna Alvarado
Telephone #	(916) 845-5683
Attorney	Pat Kusiak

FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO ABX1 11  
AS INTRODUCED FEBRUARY 2, 2011

AMENDMENT 1

On page 5, line 36, strikeout "United States Department of Census" and insert:

Unites States Census Bureau

AMENDMENT 2

On page 7, line 20, strikeout "zone" and insert:

enterprise zone

AMENDMENT 3

On page 7, line 25, strikeout "a zone" and insert:

an enterprise zone

AMENDMENT 4

On page 7, line 34, strikeout "a zone" and insert:

an enterprise zone

AMENDMENT 5

On page 7, line 36, strikeout "a zone" and insert:

an enterprise zone

AMENDMENT 6

On page 8, line 3, strikeout “zone” and insert:

enterprise zone

AMENDMENT 7

On page 8, line 6, strikeout “zone” and insert:

enterprise zone

AMENDMENT 8

On page 8, line 15, strikeout the phrase “resolution with the ordinance” and insert;  
resolution or ordinance.

AMENDMENT 9

On page 8, line 34, strikeout “zone” and insert:

enterprise zone

AMENDMENT 10

On page 18, strikeout lines 23 through 25 inclusive, and insert:

(k) The changes made to this section by Chapter 609 of the Statutes of 1997 shall apply to taxable years beginning on or after January 1, 1997.

AMENDMENT 11

On page 18, line 27, strikeout “only”.

## AMENDMENT 12

On page 28, strikeout lines 7 and 8, and insert:

(k) The changes made to this section by Chapter 609 of the Statutes of 1997 shall apply to taxable years beginning on or after January 1, 1997.

## AMENDMENT 13

On page 28, line 10, strikeout "only".