Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Florez | Analyst: Jeani Brent | Bill Number: AB 1192

Related Bills: AB 1217 (Stats. 1997, Ch. 602) | Telephone: 845-3410 | Introduced Date: 02/26/1999

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Targeted Tax Area/Additional Designation

SUMMARY

Under the Government Code, this bill would require the Trade and Commerce Agency (TCA) to designate one additional targeted tax area (TTA). This bill would specify that TCA could designate only a community that meets certain additional criteria.

This bill would specify that, for purposes of applying any provision of the Revenue and Taxation Code, a TTA designated under this bill would not be considered an enterprise zone.

EFFECTIVE DATE

This bill would be effective on January 1, 2000, and would apply to taxable or income years beginning on or after January 1, 2000.

PROGRAM HISTORY/BACKGROUND

California has four types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Areas (MEA)

SPECIFIC FINDINGS

Under the Government Code, existing state law provides for the designation of a targeted tax area (TTA). Using specified criteria regarding unemployment, income levels, poverty levels, and percentages of people receiving Aid to Families with Dependent Children, the TCA designated the TTA from the applications received from governing bodies. The TTA was designated November 1, 1998, is binding for 15 years beginning January 1, 1998.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within the TTA. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. See attachment A for a detailed discussion of each tax incentive.

Board Position:			Department Director	Date
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This bill would require the TCA to designate one additional TTA. To qualify for designation as a TTA under this bill, a community must meet both of the following criteria:

1. Be an economic development authority created by a county having a population of less than 1 million on January 1, 1999, and a city with a population of less than 10,000.

2. Be located in a county with a natural resource-based economy that is experiencing a decline because of layoffs or lack of employment opportunities or both for specified reasons.

According to TCA, the criteria are too vague to determine which communities might qualify for designation.

Once the TTA is designated, businesses operating in the new TTA would qualify for all the tax incentives allowed to businesses in the existing TTA.

This bill would specify that, for purposes of applying any provision of the Revenue and Taxation Code, a TTA designated under this bill would not be considered an enterprise zone. The TTA designation would be binding for 15 years.

Policy Consideration

This bill does not specify that the new area must meet the general TTA designation criteria regarding unemployment, income levels, poverty levels, and percentages of people receiving Aid to Families with Dependent Children. Also, this bill does not specify that the existing TTA provision applies that allows TCA to periodically audit the program and revoke designation if identified deficiencies are not timely corrected.

Implementation Considerations

The language in this bill that specifies the TTA will not be considered an enterprise zone is unnecessary. This language appears to be patterned after similar language contained in the Manufacturing Enhancement Area statute. For the MEA, this language is necessary because the MEA provisions are contained in the enterprise zone chapter of the Government Code (Chapter 12.8). Because the TTA provisions are contained in a stand-alone chapter within the Government Code (Chapter 12.93), the language is unnecessary and potentially confusing for taxpayers.

Assuming TCA is able to designate a new TTA under this bill, implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

The revenue loss from this bill is estimated as follows:

Estimated Revenue Impact of AB 1217 Effective After December 31, 1997 (In Millions)		
1997-8	1998-9	1999-0
Negligible *	Minor Loss **	($1)

* Less than $250,000
** Less than $500,000

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

Revenue Estimate Discussion

Revenue losses under the Personal Income Tax Law and the Bank and Corporation Tax Law primarily would depend on the number of businesses in the targeted tax area that would purchase qualified property subject to the sales tax, the amount of wages paid to qualified employees, and the relevant state tax liabilities of employers claiming tax benefits.

Because the effectiveness of a new targeted tax area is unknown and the potential exists for significant businesses to locate in such an area, the average revenue loss of $1 million per area per year has been used. It is not known what, where, or when plans or development would begin. Because this provision targets a small area, it is anticipated that revenue losses would most likely be below the average in the first years of designation. Allowance is made in future years for businesses that might start up.

BOARD POSITION

Pending.

Attachment A
AB 1192 (Florez)
As Introduced February 26, 1999

TARGETED TAX AREA (TTA) INCENTIVES

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 a TTA. The amount of the credit is limited to the tax attributable to TTA area 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.

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

Hiring Credit

A business located in a TTA may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as a TTA and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the TTA and at least 50% must be performed inside the TTA. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on TTA income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage.

Business Expense Deduction

A business located in a TTA may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the TTA. The deduction is allowed in the taxable or income year in which the taxpayer places the qualified property in service. The property's basis must be reduced by the amount of the deduction. 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 a TTA may elect to carry over 100% of the TTA net operating losses (NOLs) to deduct from TTA 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 TTA.

Apportioning

For businesses operating inside and outside a TTA, the amount of credit or net operating loss deduction that may be claimed is limited by the amount of tax or income attributable to the TTA. 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). This income is further apportioned to the TTA using a two-factor formula based on the property and payroll of the business.