

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Alarcon Analyst: Jeani Brent Bill Number: SB 511

Related Bills: \_\_\_\_\_ Telephone: 845-3410 Amended Date: APTBA

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

**SUBJECT:** Enterprise Zone/Hiring Credit/Modify Qualified Taxpayer

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

OTHER - See comments below.

## SUMMARY OF BILL

Under the Revenue and Taxation Code, this bill would modify the enterprise zone hiring credit to allow the credit only to taxpayers that pay livable wages to at least 80% of their qualified employees and provide health benefits to all of their qualified employees, both as determined by the Trade and Commerce Agency.

Under the Government Code, this bill would require the Trade and Commerce Agency (TCA), when reviewing and ranking enterprise zone applications, to give special consideration or bonus points, or both, to applications that meet two of three specified criteria. This analysis will not discuss this provision as it does not impact the department's programs and operations.

## SUMMARY OF AMENDMENT

The proposed amendments removed the bill's provisions that would have increased the number of enterprise zones and replaced them with the provisions discussed in this analysis.

## EFFECTIVE DATE

This bill would become effective January 1, 2001, and would apply to taxable or income years beginning on or after January 1, 2001.

## PROGRAM HISTORY/BACKGROUND

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

Board Position:

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Department Director

Date

**Johnnie Lous Rosas**

**12/23/99**

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

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	
Hiring Credit	X	X	X	X
Employee Wage Credit	X			
Business Expense Deduction	X	X	X	
Net Interest Deduction	X			
Enhanced Net Operating Loss	X	X	X	

#### SPECIFIC FINDINGS

**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 Trade and Commerce Agency (TCA) designates enterprise zones from the applications received from the governing bodies. Enterprise zones are designated for 15 years (except enterprise zones meeting certain criteria may be extended to 20 years), and TCA has designated each of the 39 enterprise zones authorized under existing law. When an enterprise zone expires, TCA is authorized to designate another in its place (or redesignate the existing zone) to maintain a total of 39 enterprise zones. TCA may approve the geographic expansion of enterprise zones up to 15% in size and, for certain small enterprise zones, up to 20% in size.

TCA may audit enterprise zone 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 or income year prior to dedesignation may continue to avail itself of those tax incentives for a period equal to the remaining life of the enterprise zone, provided the business otherwise is still eligible for those incentives. Once an enterprise zone is dedesignated, TCA may designate another enterprise zone in its place to maintain a total of 39 enterprise zones, even though taxpayers in the dedesignated zone may continue to use the tax incentives that the taxpayers qualified for prior to dedesignation.

**Under the Revenue and Taxation Code, existing state law** provides special tax incentives for taxpayers conducting business activities within an enterprise zone. 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 within an enterprise zone may claim a wage credit.

The enterprise zone hiring credit allows a taxpayers operating a business in an enterprise zone to reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an enterprise zone and meet certain other criteria. At least 90% of the qualified employee's work must be related directly to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone. The business may claim up to 50% of the wages paid to a qualified employee as a

credit against tax imposed on enterprise zone income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (under special circumstances for the Long Beach enterprise zone, the maximum is 202% 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.

**This bill** would modify the enterprise zone hiring credit to allow the credit only to taxpayers that pay livable wages, as determined by TCA, to at least 80% of their qualified employees within the enterprise zone, and provide health benefits, as determined by TCA, to all of their qualified employees within the enterprise zone.

#### Policy Considerations

The enterprise zone tax benefits are designed to encourage businesses to operate in economically disadvantaged areas. This bill may negate the credit's incentive by imposing additional restrictions on its usage.

Enterprise zones are designated for 15-year periods. This bill would apply its hiring credit restrictions to businesses located in all enterprise zones regardless of when the enterprise zones were designated, rather than only to those businesses located in enterprise zones designated after the bill's effective date. Changing a tax incentive before the zone's expiration date may be viewed as unfair to taxpayers that relied on the tax benefit as an incentive to open businesses within the zone.

#### Implementation Considerations

The bill does not define "livable wage" or "health benefits." Although TCA and not the department would be responsible for determining whether the taxpayer pays both a livable wage and provides health benefits to its employees, this bill could impact the department if taxpayers dispute TCA's determination. Requiring TCA to certify annually those taxpayers that meet the requirements would resolve this issue.

### FISCAL IMPACT

#### Departmental Costs

Assuming that the implementation concern is resolved, this bill would not significantly impact the department's costs.

#### Tax Revenue Estimate

Definitions are needed regarding "livable wage" and "health benefits." Without those definitions, it is not possible to project the revenue effect of this bill.

According to departmental data, the total amount of hiring tax credits applied for enterprise zone activity in California was nearly \$13 million for tax year 1996. It is projected for year 2000 that applied hiring tax credits will increase to more than \$25 million. The reason for the

significant increase is the repeal of the Los Angeles Revitalization Zone (LARZ). (Taxpayers in formerly overlapping enterprise zone and LARZ areas now will generate only new enterprise zone incentives, which will increase the amount of enterprise zone credits claimed).

BOARD POSITION

Pending.