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(916) 651-4103
FAX (916) 323-8386

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July 3, 2013
Upon Call of the Chair, Room 112

SB 90 – Economic Development Reform

SENATE COMMITTEE ON BUDGET AND FISCAL REVIEW
Mark Leno, Chair

Bill No:	**SB 90**
Author:	**Senators Galgiani and Cannella**
As Amended:	**July 2, 2013**
Consultant:	**Mark Ibele**
Fiscal:	**Yes**
Hearing Date:	**July 3, 2013**

Subject: This is an economic development bill that makes various changes in the state tax system beginning in 2013-14. The proposed statutory changes are related to the approval by the Legislature of tax law measures in AB 93, designed to encourage economic development and the phase-out other of existing tax incentives.

Summary: This measure clarifies certain provisions of AB 93 and institutes various changes that expand the availability of tax credits and exemptions provided under that legislation. Under the measure, the length of time for the sales and use tax (SUT) exemption would be extended to eight years. In addition, the applicability of the hiring credit under the personal income tax (PIT) and the corporation tax (CT) would be expanded by including certain additional geographic areas and adding additional criteria for eligible employees. Finally, the bill would establish pilot areas under the hiring credit with somewhat expanded criteria in order to determine the effectiveness of alternative incentive structures.

Background: The state imposes a tax on the sale and use of tangible personal property, a tax on personal income, and a corporation tax based on income. For each tax, there are various special tax expenditure programs designed to encourage or reward particular economic activities. AB 93, as approved by the Legislature, would enact significant changes to these programs. This bill would result in additional changes to those effectuated by AB 93. Current law and legislative changes pursuant to AB 93 establish the following:

1. **Sales and Use Tax Exemption.** California's SUT law imposes the sales tax on the sale of tangible personal property in the state and the use tax on the storage, use, or other consumption of tangible personal property in the state, including equipment and similar business purchases, except where a specific exemption is provided. As amended by AB 93, an exemption is allowed from the state portion (General Fund and Education Protection Fund) of the SUT, beginning July 1, 2014 and before January 1, 2019, for certain purchases by qualified purchasers that are used in designated activities. The exemption extends up to July 1, 2021 for property purchased for use in designated census tracts and former enterprise zones (EZs). The combined rates related to the exemption currently total 4.19 percent. The exemption would be limited annually to the first $200 million of otherwise eligible purchases by a qualified purchaser. Qualified purchasers that would be eligible for the SUT exemption are identified by designated codes of the North American Industry Classification System (NAICS), largely comprising manufacturing and research and development industries. Eligible purchases would generally include equipment and other tangible personal property related to these manufacturing and research and development activities.

2. **Hiring Credit.** Pursuant to AB 93, a new hiring tax credit is established under the personal income tax (PIT) and corporation tax (CT), from January 1, 2014 to January 1, 2021, for additional hiring of employees in defined geographic areas of the state. The hiring credit would be available in the geographic areas largely covered by the former

EZs (except certain census tracts with low unemployment), two recently expired EZs, and in designated census tracts that have a civilian unemployment rate and a poverty rate in the top 25 percent of all census tracts in the state. The credit percentages for all hiring credits are 35 percent per year for five years, for wages between 150 percent and 350 percent of the minimum wage (currently between $12 and $28 per hour). The credit is available for full-time employees who perform at least 50 percent of their activities in the designated areas. Generally, (except for small businesses that claim the credit), the following apply: (1) taxpayers from a temporary agency, retailer, restaurant or drinking establishment, as defined by the NAICS codes are prohibited from receiving the hiring credit; and (2) taxpayers that move into an EZ are required to provide an "offer of transfer" to its employees with comparable compensation. Important features of the hiring credit include the following:

a. **Employee Characteristics.** Employees must meet one of the following criteria: (1) have been previously unemployed for six months; (2) received the Earned Income Tax Credit (EITC); (3) have served in the United States Military, or (4) be an ex-offender. Tax credit requests regarding an eligible employee who also happens to reside in a TEA would be expedited.

b. **Net New Jobs.** In order to qualify for any credit, the taxpayer must have experienced an increase in total jobs throughout the state from one year to the next. Taxpayers are only allowed the credit for the number of new jobs provided in the state.

c. **Small Business Provisions.** Small businesses are defined as businesses with annual gross receipts of under $2.0 million. Small business must comply with all requirements of the program except the offer of transfer and the industry limitations noted above.

d. **Credit Administration.** Taxpayers may only qualify for the credit if it is on the original filed timely return with the Franchise Tax Board (FTB); no credit may be claimed on an amended return. Taxpayers with qualified employees that meet the net new jobs test must reserve a credit with the FTB, which must be claimed on an original filed timely return. FTB is required to compile a list of the hiring credit vouchers claimed and number of new jobs created for each taxable year.

3. **Enterprise Zone Programs.** Under current law, special tax programs are available for designated EZs, as well as certain other geographic areas, comprising Local Area Military Base Recovery Areas (LAMBRAs), Targeted Tax Areas, Manufacturing Enhancement Areas, and the Los Angeles Revitalization Zone. Taxpayers with business activities located in an EZ and similar areas can claim various tax incentives through both the PIT and CT, including tax credits for hiring certain qualified individuals, sales taxes paid on equipment purchases, and net interest deductions for banks making loans to an EZ business. In addition, EZ businesses may benefit from accelerated depreciation of equipment and the carry-over of 100 percent of business losses to future tax years. As amended by AB 93, the programs related to tax incentives for activities in EZs and similar areas would generally no longer be effective beginning January 1, 2014. However, with respect to the EZ hiring credit, for employees employed by the qualified taxpayer prior to January 1, 2014, the wages paid with respect to those employees would continue to qualify for the credit for any remainder of the five-year period. In addition, credits claimed, or earned, under the EZ program and carried-over from prior years, could continue to be applied to tax liabilities for up to ten years.

Proposed Law: The bill would make certain changes to the economic development programs instituted or altered pursuant to AB 93. In addition, the bill contains certain other statutory provisions. Specifically:

1. **Sales and Use Tax Exemption.** The bill would extend the exemption from the state portion of the SUT for manufacturing and research and development equipment established by AB 93 to eight years, from July 1, 2014 to July 1, 2022, on a statewide basis. In so doing, the extended exemption period for designated census tracts and former EZs in AB 93 would be rendered immaterial, and consequently the provision establishing this program would be removed pursuant to the bill.

2. **Hiring Credit.** Under the proposal, eligible employees for the hiring credit established by AB 93 would be expanded to include a recipient of CalWORKs or General Assistance. The definition of ex-offender eligible employee would also be refined under the proposal as "ex-offenders previously convicted of a felony." Employers eligible for the hiring credit (including the small business set-aside) would exclude sexually-oriented businesses, as defined. The eligible areas for the credit set forth in AB 93 are also expanded under this bill to include LAMBRAs, which, together with former EZs (including certain former EZs inadvertently omitted in AB 93), are termed "economic development areas."

   The bill would allow the Governor's Office of Business and Economic Development (GO-Biz) to designate five pilot areas, where eligible wages for the credit would be amounts over $10 per hour, rather than the $12 per hour floor established in AB 93. Eligible pilot areas are those within a designated census tract or economic development area with average wages less than the statewide average and areas within a designated census tract or economic development area based on high poverty or high unemployment. One or more of these pilot areas must be an area within five or fewer designated census tracts within a single county based on high poverty or high unemployment or an area within an economic development area based on high poverty or high unemployment. Pilot areas would be initially designated for four years, with an extension of up to three additional years at the sole discretion of GO-Biz. The applicable period of the pilot area, and any extension, would not be effective beyond December 31, 2020.

3. **Enterprise Zone Programs.** The proposed law would clarify that the ten-year carryover would apply to existing credits that have been claimed, but not applied to a tax liability by the taxpayer, as well as credits that are earned subsequent to January 1, 2014. The bill also includes language regarding legislative findings and declarations in this regard.

4. **Contingency and Urgency.** The bill specifies that it becomes operative only if AB 93 is chaptered and becomes operative. The bill is identified as an urgency measure to go into effect immediately.

Fiscal Effect: Estimated revenue impacts of the economic development reform legislation are contained in the Senate Floor analysis of AB 93. SB 90, by increasing the time allowed to claim the SUT exemption for eligible purchases, will result in additional revenue reductions in the years outside the budget window. In addition, SB 90 in some cases expands, and in another cases narrows, the applicability of the hiring credit contained in AB 93, as adopted by the Legislature. These changes will result in somewhat different revenue losses associated with the hiring credit component, compared to AB 93. Total revenue losses associated with altered hiring credit are estimated to be: -$8.0 million in 2013-14; -$39.0 million in 2014-15; -$77.0 million in 2015-16; and, -$126.0 million in 2016-17. There are also unknown, but likely minor revenue reductions associated with the pilot areas designated by GO-Biz.

Support: NA

Opposed: NA

Comments: This measure clarifies certain provision of AB 93 and institutes various changes that expand the availability of tax credits and exemptions provided under that legislation. The length of time for the SUT exemption and the availability of the hiring credit would be expanded. Certain additional areas would be included in the hiring credit and the criteria for eligible employees increased. Finally, the bill would establish pilot areas under the hiring credit with somewhat looser criteria in order to determine the effectiveness of alternative incentive structures.