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Tax Incentive Areas—Designation and Benefits

- ☑ Tax incentive areas—Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs)—were selected based largely on their socio-economic characteristics and on their prevailing level of economic distress.

- ☑ Legislation was effective in 1984 for EZs, in 1998 for MEAs and the TTA, and in 1993 for LAMBRAs.

- ☑ Extensive tax benefits are available for employers located in zones—including hiring credits, sales and use tax credits (SUT), accelerated depreciation, net interest deductions for lenders, and the longer carryforward of net operating loses.

  - In some cases there can be preferential treatment for state contracts.
  - Benefits are also available for having employees who reside in a Targeted Employment Area (TEA).

- ☑ Tax benefits vary based on the designation of the zone, as shown in the table below.

	Hiring Credit	Longer NOL Carryforward Period	Sales and Use Tax Credit	Accelerated Depreciation	Lender Interest Deduction
Enterprise Zones	X	X	X	X	X
Manufacturing Enhancement Zones	X				
Targeted Tax Areas	X	X	X	X	
Local Agency Military Base Recovery Areas	X	X	X	X	

Tax Incentive Areas—Number and Expiration

- ☑ There are 42 separate EZs—including six multijurisdictional zones—resulting in 56 separate locations.
  - Original draft legislation for EZs in 1983 called for establishing no more than ten zones in the state.
  - In 2006, 18 EZs expire unless their status is renewed through legislation. Another 13 expire in 2007 and 2008. The remaiing EZs expire between 2009 and 2012.
- ☑ In addition, there is one TTA, two MEAs, and eight LAMBRAs.
  - The TTA expires in 2013 and the MEAs in 2012.
  - The LAMBRAs expire between 2007 and 2012.

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Tax Incentive Areas—Program Usage

- ☑ The total revenue impact on the state is currently in the low hundreds of millions of dollars annually.
  - For all tax incentive programs and for all types of areas, income taxes for tax year 2003 were reduced by about $318 million.
  - Tax returns claiming some form of tax incentive for all the programs totaled 9,544 for 2003.
  - The Corporation Tax (CT) accounted for 70 percent of these revenue reductions and 50 percent of the returns.
- ☑ EZs accounted for $282 million of the $318 million total revenue reduction. Claims under the now-expired Los Angeles Revitalization Zone accounted for almost all the remaining $36 million.
- ☑ The hiring credit is by far the most "expensive" for the state in terms of forgone revenues. In 2003, this accounted for $178 million of the CT revenue reduction attributable to EZs.
  - Of these credits granted to "known zones," 27 percent went to San Francisco, Long Beach, Oakland, and Santa Ana.
- ☑ For the CT, 45 percent of the benefits went to trade and financial services, and 24 percent went to manufacturing.
- ☑ In 2003, 57 percent of the tax benefits went to companies with assets of $1 billion and over, and 50 percent of the tax benefits went to companies with receipts of $1 billion or more.

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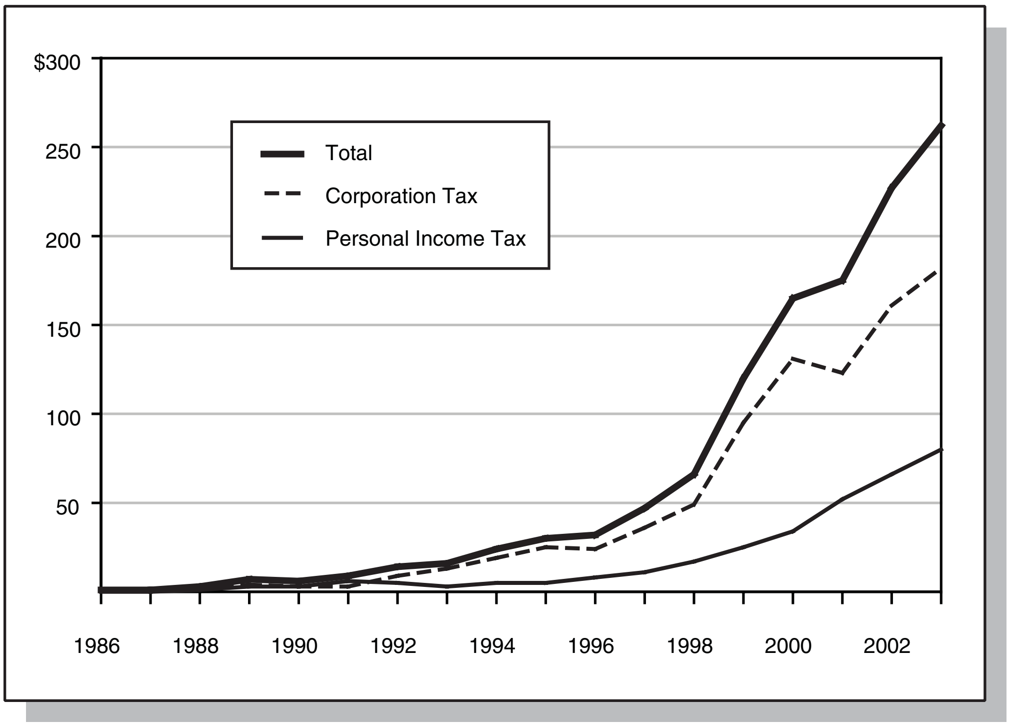
Tax Incentive Areas—Program Trends

Hiring and Sales and Use Tax Credits
(In Millions)



- ☑ Revenue analysis in 1983 by Franchise Tax Board (FTB) indicated that the revenue impacts would depend on the number of tax incentive zones and the response to them from the business community, but that such revenue reductions “could be in the millions.”

- ☑ Usage of the hiring credit and SUT credit in EZs have expanded dramatically over the life of the program, as shown in the figure.

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Tax Incentive Areas— Program Trends *(Continued)*

- ☑ The tax effect of the EZ net interest deduction for lending institutions has also expanded rapidly.
  - For CT taxpayers, this expanded from $4.6 million in 1995 to $23 million in 2003. It is estimated to be in excess of $25 million for 2004.
  - Tax returns claiming this incentive grew by 120 percent over the period.
- ☑ Tax credits claimed through amended returns totaled $170 million over the five years 1999 through 2003.
- ☑ The number of employees reported on tax returns grew from 24,190 to 71,150 between 1999 and 2003.
- ☑ Companies that do not have a tax liability in the year that the credit is earned may carry over such credits into future years.
  - The amount of carryover credits has increased, from $48 million in 1997 to $553 million in 2003, and are currently estimated by FTB to be approximately $650 million.

Tax Incentive Areas—Program Effectiveness

- ☑ Research findings on geographic tax incentives in general are rather mixed—with some investigations indicating a positive response and others suggesting no response.

- ☑ Overall, however, the weight of research results suggest that any response is likely to be small in general and may result in revenue losses that are significant relative to the benefits received.

- ☑ Most research indicates that these types of incentives have little if any impact on overall *level* of economic activity or employment and thus would not have a positive impact on the economic base of the state overall.

- ☑ However, such incentives may have an impact on the geographic *distribution* of such economic activity.

  - This impact on the location of economic activity is not likely to occur for large regions or states, since other factors such as labor markets and consumer demand are more important.

  - The impact on location is likely to occur in smaller areas—such as metropolitan regions—as businesses are apt to weigh where to locate within a single market.

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Tax Incentive Areas—Policy Issues

- ☑ ***Retroactive Credits.*** The ability of taxpayers to amend past returns and claim hiring credits removes the incentive aspect of the program. In this sense, the program provides more of a reward than an incentive.

- ☑ ***Cross Vouchering.*** This feature allows one enterprise zone to issue a voucher indicating eligibility for the hiring credit for employment in a different EZ. This may not provide adequate oversight of EZ administration.

- ☑ ***Employee Qualifications.*** Current law may—in certain situations—allow tax incentives for the employment of individuals who may not have any substantial barriers to employment.

- ☑ ***Targeted Employment Areas.*** These allow employers in EZs to employ individuals who may not possess any barriers to employment but reside in a low-income area. Current law provides for no update of TEA designation.

- ☑ ***Interest-Paid Deduction.*** This program may provide incentives for companies whose major activities are actually located outside of a tax incentive zone.

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California's Enterprise Zone Program

LEGISLATIVE ANALYST'S OFFICE

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