

Date of Hearing: April 20, 2010

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE
ECONOMY

V. Manuel Perez, Chair

AB 2476 (V Manuel Perez and Caballero) – As Amended: April 13, 2010

SUBJECT: Enterprise Zones and targeted employment areas

SUMMARY: Tightens the criteria for designating a targeted employment area (TEA) for the purposes of establishing one of thirteen worker eligibility criteria under the Enterprise Zone (EZ) hiring tax credit requirements. Specifically, this bill:

- 1) Modifies the definition of a TEA for areas designated after December 31, 2010, by increasing the percentage of low and moderate income residents from 51% to 61% and by refining the unit of measurement from census tract to census block.
- 2) Requires local governments with a TEA designated prior to December 31, 2010, to use the new definition when they review and update the boundaries of their TEA to conform to the 2010 census data becoming available.
- 3) Makes other related technical changes.

EXISTING LAW

- 1) Purpose of EZ program: Establishes the EZ Program, administered by California Department of Housing and Community Development (HCD) to stimulate business and industrial growth and create jobs in depressed areas of the state. A maximum of 42 EZs are authorized at any one time. Designations are for a period of 15 years, as specified.
- 2) Hiring Credit: Authorizes an income tax credit for businesses in an EZ that hires certain "qualified employees." Among other qualifying criteria, which are described in (6) and (7) below, the qualified employee must be certified that he or she meets one of nearly a dozen categories of individuals, including living within a TEA.
- 3) Purpose of the TEA: Specifies that the purpose of a "targeted employment area" is to encourage businesses in an EZ to hire eligible local residents. A targeted employment area may include, but is not required to include, all or part of the boundaries of the enterprise zone. Further, the targeted employment area does not need to encompass all eligible areas, but may include only those areas that the local government determines have residents who are in the most need of this employment targeting.
- 4) Definition of a TEA: Defines a targeted employment area to mean an area within a city, county, or city and county that is composed solely of those census tracts designated by the US Department of Housing and Urban Development as having at least 51% of its residents of low- or moderate-income levels, using either the most recent US Department of Census data available at the time of the original EZ application or the most recent census data available at the time the targeted employment area is designated to determine that eligibility.
- 5) Update of TEA: Requires local governments to update the boundaries of their TEA to reflect new census data within 180 days of the data becoming available.

- 6) Definition of a qualified employee: Limits the hiring credit to be awarded to only those employees that meet the following requirements:
- a) The employee provides service to an employer where at least 90% of those services within a taxable year are directly related to the conduct of a taxpayer's business or trade located in an enterprise zone;
 - b) The employee performs at least 50% of his/her service for the taxpayer during the taxable year in an enterprise zone;
 - c) The employee is hired after the date of the enterprise zone designation;
 - d) The employer has received a voucher for the employee that certifies that the employee, immediately preceding employment with this employer, met one of 12 eligibility categories. The employee was or is:
 - i) A resident of a TEA, as specified;
 - ii) Eligible for services under the federal JTPA, or its successor;
 - iii) Eligible to be a voluntary or mandatory registrant under GAIN, or its successor;
 - iv) An economically disadvantaged individual 14 years or older;
 - v) A dislocated worker, as specified;
 - vi) A disabled individual who is eligible for, enrolled in, or has completed a state rehabilitation plan;
 - vii) A service-connected disabled veteran, veteran of Vietnam, or veteran who has been recently separated from military service;
 - viii) An ex-offender, as specified;
 - ix) Eligible to receive specified social services benefits, including Federal Supplemental Security Income benefits, Aid to Families with Dependent Children, food stamps, or state and local general assistance;
 - x) A member of a federally recognized Indian tribe, band, or other group of Native American descent; or
 - xi) A member of a targeted group, as defined by the Internal Revenue Service for the purposes of the Work Opportunity Tax Credit, which includes a qualified IV-A recipient, a qualified veteran, a qualified ex-felon, a high-risk youth, a vocational rehabilitation referral, a qualified summer youth employee, a qualified food stamp recipient, a qualified Supplemental Security Income recipient, or a long-term family assistance recipient.
- 7) Further Hiring Credit Requirements: Requires "qualified employees" to be retained in employment for a minimum of 270 days (approximately 9 months) in order to qualify for

hiring credit vouchering. The value of the hiring credit incentive totals 50% of the employees's wages in the first year, 40% in the second, 30% in the third, 20% in the fourth, and 10% in the fifth year. Although employees can be paid more, the maximum wage rate used to calculate the credit is 150% of minimum wage. Aircraft manufacturers in Long Beach may calculate the credit based on 202% of minimum wage. The hiring credit may only be applied to offset tax liability attributable to revenues received from activities located within the EZ where the employee is primarily working. While not every employer is able to fully utilize the maximum value of the credit, it could be as high as \$37,700 over five years.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's purpose: The Assembly Committee on Jobs, Economic Development and the Economy (JEDE) initiated a comprehensive review of the enterprise zone and other geographically targeted economic development area (G-TEDA) programs in August 2009.

With the support of the Speaker of the Assembly, the committee is currently engaging in an extended discussion on how best to reform the G-TEDA programs. Program improvements will be amended into AB 2476.

- 2) Enterprise Zones: Existing law authorizes the creation of up to 42 enterprise zones based on a statutory list of criteria related to poverty and economic dislocation. The EZ program is based on the economic principle that targeting significant incentives to lower income communities allows these communities to more effectively compete for new businesses and retain existing businesses, which results in increased tax revenues, less reliance on social services, and lower public safety costs. Residents and businesses also directly benefit from these more sustainable economic conditions through improved neighborhoods, business expansion, and job creation.

Enterprise zones are located in portions of 54 Assembly Districts and 35 Senate Districts. Enterprise zones range in size from one square mile to 70 square miles and in geographic locations ranging from Eureka and Shasta Valley near the Oregon border to San Diego and Calexico along the Mexican border.

Under the EZ Program, businesses and other entities located within the area are eligible for a variety of local and state incentives. In its application, a prospective EZ is required to identify specific local government incentives that will be made available to businesses located in the proposed G-TEDA. The local incentives can, among other things, include writing down the costs of development, funding related infrastructure improvements, providing job training to prospective employees, or establishing streamlined processes for obtaining permits.

The state also offers a number of incentives, including tax credits, special tax provisions, priority notification in the sale of state surplus lands, access to certain Brownfield clean-up programs, and preferential treatment for state contracts. Below is a chart comparing the state tax incentives offered to businesses located in a G-TEDA.

Comparison of State Tax Benefits by Targeted Area
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	Hiring Credit	Longer NOL ¹ Carry- Forward Period	Sales and Use Tax Credit	Accelerated Depreciation	Lender Interest Deduction
Enterprise Zone	X	X	X	X	X
Manufacturing Enhancement Zone	X				
Targeted Tax Area	X	X	X	X	
Local Agency Military Base Recovery Area	X	X	X	X	

Source: Legislative Analyst's Office

The Franchise Tax Board (FTB) reported that in 2007 – the most current data available – \$481 million in credits and deductions were claimed through corporate and personal income tax (PIT) returns. Additionally, FTB reports hundreds of millions in carryover credits have been earned by businesses located in G-TEDAs, but have not been claimed. Below is a chart that displays the dollar amount of G-TEDA incentives claimed through each of the tax incentives.

	2004	2005	2006	2007
Hiring and Sales Tax Credit	\$349,127	\$362,620	\$385,677	\$430,934
NOL Deductions	\$72,326	\$74,024	\$126,106	\$207,993
Tax Impact	\$5,171	\$5,966	\$11,351	\$15,807
Net Interest Deductions	\$432,867	\$490,129	\$517,310	\$520,372
Tax Impact	\$29,103	\$32,395	\$34,156	\$34,438
Business Expense Deductions	\$4,387	\$4,770	\$4,463	\$5,136
Tax Impact	\$222	\$200	\$188	\$197
Total Tax Impact	\$383,624	\$401,181	\$431,371	\$481,376

Data Provided by the Franchise Tax Board 11/9/09

Across the U.S., 37 other states have a G-TEDA type program. Economic developers have testified that the G-TEDA programs are among the state's last remaining marketing tools for attracting new businesses and investment to California. Others, however, remain unconvinced and have suggested that this level of tax expenditure could be better spent elsewhere.

Complicating the matter is that much of the discussion around the relative successes or failures of the G-TEDA programs and individual areas is anecdotal. Of the academic attempts to assess the state's G-TEDA programs, they have produced mixed results. Some of the variance among study findings can be attributed to the limited access to good data sets. Research generally requires the development of a set of assumptions in order to undertake the study. The assumptions made in the case of the G-TEDAs have, however, left most, if not all, of the methodological approaches open to debate. Moreover, the problems in assessing the G-TEDA programs have been further complicated by a lack of consensus on why the programs have been established and what objectives are trying to be achieved.

Responding to the differing reports, HCD commissioned its own report in 2006, which looked at the impact of the program on neighborhood poverty, income, rents, and vacancy rates. The report showed that, on average, within enterprise zones between 1990 and 2000:

¹ NOL= Net Operating Loss

- a) Poverty rates declined 7.35 percent more than the rest of the state.
- b) Unemployment rates declined 1.2 percent more than the rest of the state.
- c) Household incomes increased 7.1 percent more than the rest of the state.
- d) Wage and salary income increased 3.5 percent more than the rest of the state.

Since HCD's 2006 report, two additional reports have been released. It is important to note, however, that while the reports were released in 2008 and 2009, the business development data used to form the statistical analysis are from 2004 and earlier.

In November 2008 and later revised and re-released in March 2009, economists from the University of Southern California (USC) released a report with consistent findings of the HCD report. The USC study found that federal empowerment zone, federal enterprise communities, and state enterprise zones have "positive, statistically significant impacts on local labor markets in terms of the unemployment rate, the poverty rate, the fraction with wage and salary income, and employment."

The Public Policy Institute of California released its study of the EZ program in June 2009, looking at whether the EZ program had been successful in creating more jobs than would have otherwise been established without the zone. The main finding of the report was that, "enterprise zones have no statistically significant effect on either business creation or employment growth rates." The report also noted that the effects of the program differed between zones, perhaps due to the effectiveness of the local administration. In addition, the report found that the program had a positive effect on employment under each of the following conditions:

- a) When manufacturing constitutes a small share of overall zone employment
 - b) When the zone administrator reported doing more local zone marketing activities
 - c) When the zone administrator reported doing less facilitation of the hiring tax credit
- 3) Findings from the 2009 oversight hearings: During the course of the review, JEDE held three public hearings, met with a variety of stakeholder groups, and produced an extensive white paper that details the structure and activities of the G-TEDA program in California, as well as those in other states. Speakers included representatives from a wide variety of perspectives including practitioners, researchers, nonprofits, local governments, labor, and business leaders.

At the first hearing, witnesses provided a general overview of the G-TEDA programs including presentations on the most recent program evaluation studies. The second hearing focused on how the G-TEDA programs help the state's innovation-based industries – especially those in the manufacturing area. At the third hearing, presentations were arranged around three topics: workforce training, small business development, and models for measuring success. Based on this work, JEDE made five key findings that are leading its further review of the recommendations:

- a) There is clear lack of consistency between the G-TEDA's programs' mission, their programmatic elements, and evaluation methods. Realigning these three elements is central to improving program outcomes.
- b) While a number of oversight and accountability improvements were made in 2006 (discussed below), it is too soon to tell whether the new metrics will provide the data necessary to holistically review the programs. This has resulted in having the issue of accountability has remained a topic in the current reform discussions.
- c) G-TEDA programs in other states are more targeted toward specific economic development outcomes. The white paper includes two charts which display information on how other states have chosen to implement their G-TEDA programs. Reform discussions have also included how changes in California's programs can impact the state's competitiveness, as well as making the programs more focused on specific outcomes.
- d) The current business development elements of the G-TEDA programs are insufficiently linked to current state and local programs assisting unemployed workers. While discussions are still in the preliminary stages, improving linkages between the use of federal workforce dollars, local One-Stop Career Centers, and CalWORKS is on the reform recommendation agenda.
- e) In order for the G-TEDA programs to better support small businesses, the programs will need to be refined and better adapted to the actual needs of small size businesses.

A summary of each of the three hearings, including identification of areas that could be improved and the list of recommendations, can be found in Committee's white paper, available through the JEDE office or online at www.assembly.ca.gov.

- 4) **G-TEDA Reforms in 2005/2006:** While the G-TEDA programs have been around for decades, it was not until the winter of 2005 that the first oversight hearings were held. During the course of these hearings, hosted jointly by JEDE and the Assembly Committee on Revenue and Taxation, the Committees reviewed current and best practices related to designation, management and monitoring, and use of business incentives available through the G-TEDA programs. As a result of these hearings, JEDE developed a list of 47 recommendations on how to improve the overall G-TEDA programs and drafted AB 1550 (Arambula and Karnette), Chapter 718, Statutes of 2006. Key reforms in AB 1550 include:
 - a) Requiring EZ applications to be ranked based on their economic development strategy and implementation plan, including to the extent the strategy does the following: sets reasonable and measurable benchmarks, goals, and objectives; identifies local resources, incentives, and programs; provides for the attraction of private investment; includes regional and community-based partnerships; and addresses hiring and retention of unemployed or underemployed residents or low-income individuals.
 - b) Requiring G-TEDAs to biennially report to HCD on their progress in meeting the goals and objectives identified in their implementing MOU. G-TEDAs designated prior to January 1, 2007, are required to update their goals and objectives by April 15, 2008, and meet the annual reporting requirements by October 1, 2009.

- c) Adding a new audit element that requires the review of an EZ's administrative support and whether financial commitments made in the G-TEDA application and MOU have been kept. The bill also made similar conforming changes in the MEA, TTA, and LAMBRA audit requirements.

A summary of these hearings, including background materials, is available on the JEDE Committee website.

- 5) Establishing employee eligibility: Existing law authorizes the establishment of a TEA as a means for encouraging businesses within an EZ to hire new workers that live in and around the zone. TEAs are designated by the EZ based on the most current U.S. Census data and can include areas both within and adjacent to the zone. None of the other 12 categories of eligible employee provide a nexus to the community where the actual zone is located. Well over half of the hiring credit vouchers use the TEA designation for qualifying employees.

The high usage of the TEA designation is related to a number of factors. One of the most significant advantages of the TEA over qualifying an employee under the other criteria is the employer's ability to easily access the appropriate documentation for submitting the voucher application. As an example, to demonstrate that an employee qualifies as a resident of a TEA, an employer has the option of submitting a copy of the employee's driver's license or state identification card.

In order to demonstrate that an employee qualifies for the other eligibility categories, employers have to ask employees to provide them with copies of sometimes very personal documents, including, but not limited to, bankruptcy documents, physician's statements, letters from parole, and public assistance records. Some employers have voiced concerns about asking employees questions about their eligibility other than being a resident of a TEA.

Further clouding an accurate understanding of which employees are being advantaged by the program is the fact that employers voucher employees based on a single category of eligibility. This means that to the extent that an employee is living in a TEA, is a Vietnam Veteran and a member of a federally recognized tribe, was unemployed and receiving assistance at the local One Stop Career Centers at the time of employment in a company located in an enterprise zone, the current data system can only register one category of eligibility – most likely that being that the employee lives in a TEA.

- 6) Related legislation: The following is a list of related legislation.
 - a) AB 121 (Maze) and AB 2709 (Maze) – Hiring Credit Eligibility for Former Foster Youth: These bills would have established a separate category of employee eligibility under the California Enterprise Zone Program's hiring income tax credit program to include a person who was a former foster care recipient. Status: Held in Assembly Committee on Revenue and Taxation during the 2007-08 Session.
 - b) AB 579 (Swanson) – LAMBRA Code Update: This bill would have extended the official term of the designation of a LAMBRA from eight to 15 years, except that the term may be for 20 years if the Department of Housing and Community Development determines that certain conditions exist in year five. Status: Held in Assembly Committee on Appropriations during the 2007-08 legislative session.

- c) AB 1550 (Arambula) – Final Enterprise Zone Reform Act from 2005-06 Session: This bill made a number of significant changes to the management and oversight of the G-TEDA programs. This bill is the result of extensive oversight hearings by JEDE and Revenue and Taxation, as well as extended discussions with stakeholder groups. Status: Signed by the Governor, Chapter 718, Statutes of 2006.
- d) AB 1766 (Dymally) – Initial Enterprise Reform Act from 2005-06 Session: This bill would have made a number of significant changes to the G-TEDA Program's including streamlining the selection criteria, authorizing noncontiguous zones, extending certain zone designations, and tightening up of the TEA. Status: Held on the Senate Floor in the 2005-06 Session.
- e) AB 2044 (Caballero) – Cap on Enterprise Zone Credits: This bill places annual caps on certain EZ related tax credits and increases the basis for calculating the hiring credit from 150% of minimum wage to 250%. Status: Pending in JEDE.
- f) AB 2589 (Runner) – Aggregate Credits to Offset Tax Liability within Zones: This bill would have authorized a business to use credits generated in an EZ to offset taxes attributable to the business from any EZ. Status: Held in the Assembly Committee of Revenue and Taxation during the 2005-06 Session.
- g) SB 1008 (Duchney) – Initial Enterprise Reform Act from 2005-06 Session: This bill would have made a number of significant changes in G-TEDA Program including streamlining the selection criteria, authorizing noncontiguous zones, extending certain zone designations, and tightening up of the TEA. Status: Held in the Assembly Committee on Jobs, Economic Development, and the Economy during the 2005-06 Session.
- h) SB 341 (Lowenthal) – EZ CEQA Reform: This bill would have expanded the ways in which a local government applying for an EZ designation after October 1, 2007, may meet the requirements of California Environmental Quality Act and eliminates the ability of these jurisdictions to limit subsequent environmental reviews based on the contents of the initial CEQA documents. Status: Signed by the Governor, Chapter 643, Statutes of 2007.
- i) SB 763 (Lowenthal) – Voucher Fees: This bill expanded HCD's fee authority for the purpose of offsetting the cost of administering the geographically-targeted economic development area programs. Status: Signed by the Governor, Chapter 634, Statutes of 2006.
- j) SB 974 (Steinberg) – Career Training Credit: This bill would authorize a tax credit for employers who provide specified career technical education and modify the definition of "ex-offender" for the purposes of the EZ hiring credit. The bill provides legislative intent that the EZ programs have been ineffectual and should be phased out for incentives that enhance workforce development and high school graduation rates. Status: Pending in Senate Education Committee.

REGISTERED SUPPORT / OPPOSITION:

Note

The JEDE Committee has received 76 letters relating to the pending reform discussions on Enterprise Zones. The letters came from a variety of small business owners, local governments and individuals. 75 letters expressed their support for enterprise zones and 1 expressed opposition.

Support

Assembly Committee on Jobs, Economic Development and the Economy, (sponsor)

Opposition

None known

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