

Date of Hearing: April 25, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

AB 162 (Cervantes and Quirk-Silva) – As Amended February 28, 2017

SUBJECT: Income taxation: credits

SUMMARY: Modifies the definition of a small business under the California Competes Tax Credit to mean any business with 50 or fewer full-time equivalent employees, on average, in the current and two preceding tax years.

EXISTING LAW:

- 1) Establishes the California Competes Tax Credit for the purpose of awarding individually negotiated tax credits to businesses that operate in California.
- 2) Requires at least 25% of the tax credits be awarded to small businesses on an annual basis.
- 3) Defines a "small business" as having net revenues reportable to the state of less than \$2 million in the prior tax year. The FTB is responsible for providing GO-Biz with the information as to whether a taxpayer qualifies as a "small business."

FISCAL EFFECT: Unknown

POLICY FRAME:

During the 2015-16 legislative session, the Assembly Committee on Jobs, Economic Development, and the Economy (JEDE) undertook a comprehensive review of GO-Biz programs, including the California Competes Tax Credit Program. Among other issues raised was the reluctance of some smaller size companies, particularly those in the tech sector, to have their specific revenues highlighted online and in other public venues. There was a concern that this information could impede the businesses' ability to attract private capital in the future.

Given that the California Competes Tax Credit was specifically developed to serve businesses that provide higher wages, program elements that exclude or discourage technology firms is counter to the credit's purpose. This issue could be addressed in one of two ways, reduce the public reporting and disclosure requirements or establish a new way to define small business that doesn't serve as a deterrent to certain high growth start-ups. This bill proposes to identify small businesses by number of employees. The analysis includes information on the California small business economy, the California Competes Tax Credit Program, and related legislation. Amendments are noted in Comment 4.

COMMENTS:

- 1) **The Role of Small Businesses within the California Economy:** California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.4 trillion economy. Two separate studies, one by the U.S. Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among other advantages, small businesses are crucial in the state's international competitiveness and

are an important means for dispersing the positive economic impacts of trade within the California economy.

Sole proprietorships comprise the single largest component of businesses in California, 3.1 million out of an estimated 4 million firms in 2014, representing over \$162 billion in revenues with the highest number of businesses (over 539,000) in the professional, scientific, and technical services industry sector.

Excluding sole proprietorships, businesses with less than 20 employees comprise over 86% of all businesses and employ approximately 24% of all workers. Businesses with less than 100 employees represent 97% of all businesses and employ 54% of the workforce. These non-employer and small employer firms create jobs, generate taxes, support important industry sectors, and revitalize communities. Since the recession, these businesses have become increasingly important because of their ability to be more flexible and adaptive to both foreign and domestic market needs.

- 2) **California Competes Tax Credit:** The California Competes Tax Credit, the Sales and Use Tax Exemption, and the New Employment Credit were established in 2013 as part of a \$750 million replacement package of incentives for the California Enterprise Zones Program. Key statutory program requirements for California Competes Tax Credit include:
- a) **Allocation Years:** 2013-2014 through and including 2017-18.
 - b) **Applicable Tax Years:** January 1, 2014, and before January 1, 2025.
 - c) **Total Tax Credit Awards:** \$780 million for 5 years of credits - \$30 million (2013–14); \$150 million (2014–15); \$200 million (2015-16, 2016-17, 2017-18).
 - d) **Value of the Individual Credit:** Each credit award is individually negotiated with GO-Biz staff and approved by the California Competes Tax Credit Committee. Awards are based on the committed dollars of investment and net new jobs, as compared to the dollar amount of tax credits requested. No taxpayer may receive more than 20% of the total annual allocation.
 - e) **Program Priority:** Applications from taxpayers whose project or business is located or proposed to be located in an area of high unemployment or high poverty are required to be treated as a priority. *This is the only statutory priority under the California Competes Tax Credit.* High poverty areas are those that are at or above the federal poverty rate at the time of the tax credit award. High unemployment areas are those that are at or above the state unemployment rate at the time of the tax credit award.
 - f) **Carryforward:** Six years from the initial application of the credit, as specified in the written agreement.
 - g) **Competitive Award Criteria:** The California Competes Tax Credit is a competitively awarded credit based on the following criteria:
 - i) The number of anticipated California jobs created or retained;
 - ii) The compensation paid or proposed to be paid to its employees, including wages and fringe benefits;
 - iii) The amount of investment in this state by the taxpayer;

- iv) The extent of unemployment or poverty in the area in which the taxpayer’s project or business is proposed or located;
 - v) The incentives available to the taxpayer in this state, including incentives from the state, local government, and other entities;
 - vi) The incentives available to the taxpayer in other states;
 - vii) The duration of the proposed project and the duration the taxpayer commits to remain in this state;
 - viii) The overall economic impact in this state of the taxpayer’s project or business;
 - ix) The strategic importance of the taxpayer’s project or business to the state, region, or locality;
 - x) The opportunity for future growth and expansion in this state by the taxpayer’s business; and
 - xi) The extent to which the anticipated benefit to the state exceeds the projected benefit to the taxpayer from the tax credit.
- h) **Written Agreements:** Each award is documented through a written agreement between GO-Biz and the taxpayer. Enforcement of the individual commitment is the responsibility of the Franchise Tax Board (FTB), which is directed to review the books and records of every non-small business taxpayer who receives a credit. FTB has the authority to review the books and records of small business tax payers, but it is not mandatory.
- i) **Small Business Mandate:** At least 25% of the tax credits are required to be reserved for small businesses on an annual basis. A small business is defined as having gross receipts (less returns and allowances) of greater than \$0 but less than \$2 million in the prior tax year. FTB is responsible for providing GO-Biz with the information as to whether a taxpayer qualifies as a “small business.” Since inception, GO-Biz has awarded 24.4% of the tax credits to small businesses. Relative to the number of taxpayers receiving credits, 33.7% were small businesses.
- j) **General Fund Protection:** Although statute generally sets a specific schedule for awarding the credits, GO-Biz works in partnership with the state's tax entities to ensure the financial impact on the General Fund does not exceed \$750 million in the current and next fiscal year, including all incentives awarded through the California Competes Tax Credit, the Sales and Use Tax Exclusion, and the New Hire Credit.

The Franchise Tax Board is required to annually provide a report to the Joint Legislative Budget Committee that identifies the actual total dollar amount of the credits claimed under the California Competes Tax Credit.

- 3) **Number of Businesses Served:** Below are charts displaying information on the tax credit awards, including numbers of small businesses and non-small businesses who received credits, applied for credits, average credit award, and median credit award.

As of April 13, 2017	Number of Awardees	Number of Jobs Committed	Amount of Investment Committed	Credit Awarded
Non-Small Businesses	427	61,722	\$12,850,395,599	\$394,910,487
Small Businesses	261	9,025	\$1,643,635,316	\$97,601,794
Total Businesses	688	70,747	14,494,030,915	\$492,512,281

Data Source: GO-Biz

Fiscal Year (FY)	Total Credits Available	Total Credit Requests	Number of Non-Small Business Applications	Number of Small Business Applications	Number of Non-Small Businesses Awarded	Number Small Businesses Awarded
FY 13-14: Application Period 1	\$30,000,000	\$561,454,983	262	134	18	11
FY 14-15: Application Period 1	\$45,000,000	\$329,333,538	228	58	31	25
FY 14-15: Application Period 2	\$75,000,000	\$289,800,949	177	76	66	27
FY 14-15: Application Period 3	\$30,000,000	\$320,181,186	187	80	38	25
FY 15-16: Application Period 1	\$75,000,000	\$268,876,560	205	136	59	30
FY 15-16: Application Period 2	\$75,000,000	\$300,244,159	193	105	68	35
FY 15-16: Application Period 3	\$50,900,000	\$239,730,901	170	87	44	23
FY 16-17: Application Period 1	\$100,000,000	\$430,280,902	187	105	41	33
FY 16-17: Application Period 2	\$68,300,000	\$429,277,967	208	123	62	52

Data Source: GO-Biz

As of April 13, 2017	Average Credit Award	Median Credit Award
Non-Small Businesses	\$924,849	\$320,000
Small Businesses	\$373,953	\$100,000
Total Businesses	\$715,861	\$200,000

Data Source: GO-Biz

- 4) **Proposed Amendments:** The Committee may wish to consider if it is necessary and appropriate to clarify that nothing in the statute prohibits a small businesses from receiving a tax credit allocation from the non-small business portion of the program.
- 5) **Related Legislation:** Below is a list of bills from the current and prior sessions.
 - a) **AB 93 (Assembly Committee on Budget) California Competes Tax Credit and State Sales and Use Tax Exemption:** This bill institutes three new tax programs, a Sales and Use Tax exemption for manufacturing and bio-tech equipment and similar purchases; a California Competes tax credit

for attracting and retaining major employers; and a hiring credit under the Personal Income Tax and Corporation Tax for employment in specified geographic areas. Additionally, the bill results in the phasing-out and ending of certain tax provisions related Enterprise Zones and similar tax incentive areas, and ending the current Small Business New Jobs Credit tax incentive program. The bill also provides for allocating the California Competes tax credit through the Governor's Office of Business and Economic Development to assist in retaining existing and attracting new business activity in the state. Status: Signed by the Governor, Chapter 69, Statutes of 2013.

- b) **AB 106 (Assembly Committee on Budget) California Competes: Technical Changes 2 of 3***: This bill makes technical clarification to the Enterprise Zone Program that is set to expire on December 31, 2013, according to SB 90 and AB 93. Status: Signed by the Governor, Chapter 355, Statutes of 2013.
- c) **AB 437 (Atkins) Small Business Research and Development Grant Program**: This bill would have allowed a qualified small business to convert into cash grants up to 10% of the value of research and development credits carried over from the 2015 and 2016 taxable years to the 2017 year, or 15% for credits generated in the 2017 to 2022 taxable years. The bill would have provided for the acceleration of the taxpayer's ability to monetize the credits. Status: Vetoed by the Governor, 2015. Governor's veto message: *I am returning the following nine bills without my signature: Assembly Bill 35; Assembly Bill 88; Assembly Bill 99; Assembly Bill 428; Assembly Bill 437; Assembly Bill 515; Assembly Bill 931; Senate Bill 251; and Senate Bill 377. Each of these bills creates a new tax credit or expands an existing tax credit. Despite strong revenue performance over the past few years, the state's budget has remained precariously balanced due to unexpected costs and the provision of new services. Now, without the extension of the managed care organization tax that I called for in special session, next year's budget faces the prospect of over \$1 billion in cuts. Given these financial uncertainties, I cannot support providing additional tax credits that will make balancing the state's budget even more difficult. Tax credits, like new spending on programs, need to be considered comprehensively as part of the budget deliberations.*
- d) **AB 999 (Burke) Small Business Tax Credit**: This bill authorizes the allocation of \$15 million of tax credits to qualifying small businesses in a qualifying high-technology field based on 25% of qualifying investments. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.
- e) **AB 1399 (Medina and V. Manuel Pérez) New Markets Tax Credit**: This bill would have established the California New Market Tax Credit to stimulate investment in small businesses located in low-income communities, mirroring the federal New Market Tax Credit. Status: Vetoed by the Governor, 2014. Governor's veto message: *"This bill creates a new markets tax credit that will cost --over time-- \$200 million. I certainly endorse programs that result in private investments to help low income areas, but a bill to spend this much should be considered with other priorities during the annual budget."*
- f) **AB 2900 (JEDE) Small Business Centers Reporting**: As passed by JEDE, this bill would have required a state department that awards funds to a federal small business technical assistance center to report to the Legislature in the following year. Among other data, the department would be required to report on the number of businesses assisted, industry sectors of those businesses, and the general geographic location. Amendments taken in the Senate removed the contents of the bill and added the provisions in AB 2901 with amendments. As signed, this bill expands the mandatory annual reporting of data on the California Competes Tax Credit to include the city and county of the business location, and whether the business is located in areas of high

unemployment or high poverty, as specified. Status: Signed by the Governor, Chapter 582, Statutes of 2016.

- g) **AB 1715 (JEDE) Small Business New Market Tax Credit:** This bill authorizes the allocation of \$40 million in tax credits to financial intermediaries for the purpose of stimulating investments in small businesses located in low-income communities in California. The bill mirrors the federal New Market Tax Credit. Status: Pending in the Assembly Committee on Revenue and Taxation.
 - h) **AB 1716 (JEDE) Manufacturing and Innovation Tax Credit:** This bill extends the State Sales and Use Tax Exemption and the California Competes Tax Credit for five years. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.
 - i) **SB 90 (Galgiani) California Competes: Technical Changes 1 of 3:** This bill makes various technical changes related to the California Competes Tax Credit Program in AB 93. Status: Signed by the Governor, Chapter 70, Statutes of 2013.
- 6) **Double Referral:** The Assembly Rules Committee has referred this measure to the Assembly Committee on Revenue and Taxation (R&T) and the Assembly Committee on Jobs, Economic Development and the Economy. This measure passed on an 8 to 0 vote.

REGISTERED SUPPORT / OPPOSITION:

Support

None on File

Opposition

None on File

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