Date of Hearing: April 25, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY
Sharon Quirk-Silva, Chair
AB 1716 (Committee on Jobs, Economic Development, and the Economy) – As Amended April 17, 2017

SUBJECT: Sales and use taxes: exemption: manufacturing: income taxes: credit: jobs and investment

SUMMARY: Extends the Manufacturing and Research & Development Equipment Exemption and the California Competes Tax Credit for five 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. The final allocation year 2017-18.

2) Establishes the Manufacturing and Research & Development Equipment Exemption for the purpose of providing manufacturers and certain research and developers a partial exemption of sales and use tax on certain manufacturing and research and development equipment purchases and leases. The final equipment purchase and lease date is on or before June 30, 2022.

FISCAL EFFECT: Unknown

POLICY FRAME:

Since 2014, the Governor has vetoed 18 tax-related measures and written an almost identical veto message. Tax expenditures of this magnitude need to be considered as part of the state budget. These bills have covered a range of issues, including the establishment of new and the extension of existing business incentives. This year, the Assembly Community on Jobs, Economic Development and the Economy (JEDE Committee) chose to initiate a public discussion on the need to identify, discuss, and prepare business incentive legislation for inclusion within the Budget dialogue.

To this end, the JEDE Committee introduced a package of two bills, which included the authorization and extension of the four most significant business incentives, including the California Competes Tax Credit, the Manufacturing and Research and Development Exemption, which are the subject of AB 1716. In addition to these bills, Committee members have been encouraged to author/coauthor and support legislation that make policy changes to these programs, including, but not limited to, AB 162 (Cervantes and Quirk-Silva) and AB 600 (Cooper) relating to the two programs in this bill.

The JEDE Committee package is designed to assure that the business incentive programs have been vetted and available for inclusion within a potential tax incentive agreement within the scope of the 2017-18 budget.

The analysis includes information on the California Competes Tax Credit and the California Manufacturing and Research and Development Exemption, as well as related legislation.

COMMENTS:

1) **The Replacement Business Incentive Package**: In 2013, after several years of intense debate, the California Enterprise Zone Program was eliminated and replaced with a $780 million Governor's Economic Development Initiative (GEDI), which is comprised of the Manufacturing Equipment Sales

and Use Tax Exemption, New Employment Credit, and the California Competes Tax Credit [AB 93 (Budget), Chapter 69, Statutes of 2013 and SB 90 (Galgiani) Chapter 70, Statutes of 2013].

The intent of GEDI was to attract and retain high-value employers while at the same time ensuring accountability for the state's job creation efforts and the effective use of taxpayer dollars.

Initial Executive Branch Estimate: $485 million Manufacturing Exemption
$150 million New Employment Tax Credit
$200 million California Competes

In no tax year can the total amount of claims against the General Fund exceed $750 million. California Competes Tax Credit is required to adjust new tax credit awards in order to meet this requirement.

Both the Manufacturer Exemption and the New Employment Credit have performed less than expected. The Manufacturer Exemption was used to offset $164.5 million in sales and use tax in 2016, just under one-half of the $485 million anticipated.

Claims under the New Employment Credit were: $340,822 in 2014; $693,323 in 2015; and $0 in 2016; and $0 in the first quarter of 2017, according to the Board of Equalization's annual report on the program and its website.

2) **California Competes Tax Credit**: The California Competes Tax Credit is a state-wide program available to both large and small businesses, with credits awarded based on the number of jobs created/retained and capital investments made.

The tax credit program is administered through Governor's Office of Business and Economic Development (GO-Biz) with a five-member committee specifically approving credit awards. The California Tax Credit Committee is comprised of the Director of GO-Biz (chair), the State Treasurer, the Director of the Department of Finance, and one appointee each by the Speaker of the Assembly and Senate Committee on Rules. 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 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 Employment 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) **Manufacturing and Research & Development Equipment Exemption**: The Manufacturing and Research & Development Equipment Exemption is a statewide program that provides a partial sales tax exemption on certain equipment leases or purchases by qualifying manufacturers and research entities. The program is administered through the Board of Equalization. Key elements of the program include:

   a) ***Applicable Tax Years***: On or after January 1, 2014, and before July 1, 2022.

   b) ***Reduced Tax Rate***: The portion of the sales and use tax that is allocated to the state is eliminated. From July 1, 2014 through December 31, 2016, the partial exemption rate was 4.1875%. For purchases from January 1, 2017 through June 30, 2022, the rate is 3.9375%.

   c) Initial Executive Branch Estimate in 2013: $485 million. Actual usage was $128 million in 2015 and $165 in 2016.

   d) ***Qualifying Taxpayer***: A person who is primarily engaged in lines of business described under the North American Classification System (NAICS) as a businesses within 311100 to 339999 for a manufacturer and 541711 or 541712 if the business is engaged in research and development.

   e) ***Qualifying Business***: The establishment is classified under NAICS as businesses within 311100 to 339999 for manufacturers and 541711 or 541712 if the business is engaged in research and development.

   f) ***Industry Sectors Served***: No requirement to track and report industry sector.

   g) ***Number and Size of Business Served***: No requirements to identify or report size of business claiming the exemption.

   h) ***Qualified Equipment***: Tangible personal property includes: machinery or equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures; equipment or devises used to operate, control, regulate or maintain machinery; and equipment used in pollution control; and special purpose buildings and foundations used an integral part of manufacturing, processing, refining, fabricating, or recycling processes, or that constitute research or storage facility used during any of these processes.

   i) ***Qualified Equipment Use***: Machinery or equipment used more than 50% of the time in manufacturing, processing, refining, fabricating, recycling, or research and development in biotechnology, physics, engineering, and life science.

   j) ***Useful Life***: The equipment is required to be treated as having a useful life of one or more years for state income or franchise tax purposes.

   k) ***Maximum Exemption Value***: The exemption only covers the value of the equipment up to $20 million.

   l) ***Obtaining the Exemption***: When making a qualified purchase, the taxpayer is required to provide the seller with a partial exemption certificate. The certificate includes information on the purchaser but does not require size of business, NAICS of the business, or cost of equipment.

   m) ***Reporting***: By March 1, following the close of the calendar year, the Board of Equalization is required to provide a report to the Joint Legislative Budget Committee on the total dollar amount of exemptions taken in the preceding calendar and an estimate of use for the calendar year. If the total dollar amount taken is less than the estimate, recommendations are required to be included for increasing the exemptions taken to meet the estimate.

n) ***Forfeiture of Exemption***: If the equipment purchased is purchased by another entity, removed from California within one year, or converted for different non-qualifying use, the taxpayer is required to pay the state sales, i.e. the value of the exemption.

o) ***Cost of Equipment***: No requirement to report on cost of equipment on which the exemption is claimed. This means there is no tracking as to whether the $20 million limit on cost of equipment is sufficient.

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 1399 (Medina and V. Manuel Pérez) New Markets Tax Credit:*** This bill would have established the California New Market Tax Credit for businesses that invest 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.*"

e) ***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, Statues of 2016.

f) ***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) **Possible Double Referral**: The Assembly Rules Committee referred AB 1716 as a single referral to the JEDE Committee. Following this assignment, the Assembly Committee on Revenue and Taxation requested a double referral of the measure. Staff will be monitoring the situation. There was no response from the Assembly Rules Committee at the time of publication.

REGISTERED SUPPORT / OPPOSITION:

Support

Southwest Legislative Council

Opposition

None on File

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