

Date of Hearing: April 17, 2018

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

AB 2312 (Eduardo Garcia) – As Amended March 20, 2018

SUBJECT: Taxation: California Competes Tax Credit

SUMMARY: Authorizes the California Tax Credit Committee to make a preliminary award of California Competes Tax Credits to certain local governments for the purpose of attracting and retaining manufacturing facilities with a significant number of jobs. Specifically, this bill:

- 1) Authorizes a city, county, or city and county, to apply to the California Tax Credit Committee for a preliminary tax credit award on behalf of a prospective manufacturer.
- 2) Requires a local government applicant to be competing for the creation or retention of manufacturing jobs.
- 3) Authorizes the California Competes Tax Credit Committee to award up to 50% of the value of unallocated tax credits from the preceding fiscal year for preliminary awards related to the creation or retention of regionally significant manufacturing jobs.
- 4) Expresses legislative intent that these statutory changes be included in any future extension of the California Competes Tax Credit.
- 5) Makes technical changes to conform statute to existing law relating to the elimination of the Board of Equalization and the establishment of the California Department of Tax and Fee Administration.
- 6) Provides, as a tax levy, for immediate implementation upon enactment.

EXISTING LAW establishes the California Competes Tax Credit for the purpose of awarding individually negotiated tax credits to businesses that operate in California. The amount of the award is based on a number of conditions, including, but not limited to, the number of jobs being created, the compensation-level of employees, the amount of investments made, and the location of the project or business. Priority is provided to projects and businesses located in high unemployment and high poverty areas.

FISCAL EFFECT: Unknown

POLICY FRAME: While California is considered a global economic leader, the state has also gained a reputation for being difficult to operate a business within. This reputation, whether deserved or not, places unique challenges on a local community when trying to attract new manufacturing facilities. One specific challenge is that the state does not have a "closing fund" or method for earmarking a tax benefit prior to the manufacturer choosing California and applying on their own.

AB 2312 establishes a process for a local government that is competing for a new or expanding manufacturing facility to reserve a portion of unused credits from the prior year. This reservation of credits could then be included within the community's bid package. The analysis includes information on the Governor's Economic Development Initiative (GEDI), the California Competes Tax Credit, related committee oversight hearings, and the 2018-19 Governor's proposed budget. Suggested amendments are included in Comment 8.

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 and Research and Development Sales and Use Tax Exemption, New Employment Tax 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
 \$835 million

Statute limits the exposure of the General Fund by specifying that in no tax year can the total amount of claims against the General Fund exceed \$750 million. The California Competes Tax Credit is required to adjust new tax credit awards in order to stay within this limit.

Both the Manufacturing and Research and Development Sales and Use Tax Exemption and the New Employment Credit have performed less than expected. Below is information on utilization of these incentives.

- ***Manufacturing and Research and Development Sales and Use Tax Exemption:*** \$54.3 million in 2014 (partial year); \$154.7 million in 2015; and \$164.5 in 2016.
 - ***New Employment Credit:*** \$340,822 in 2014; \$693,323 in 2015; and \$0 in 2016 according to the Franchise Tax Board's annual report on the program and its website.
 - ***California Competes Tax Credit:*** \$0 in 2014; \$13.1 million in 2015; and \$18.7 million in 2016 (does not include all fiscal year filers).
- 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 the 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. As of March 31, 2018, the committee has met 11 times and approved 865 written agreements.

Key statutory program requirements for California Competes Tax Credit include:

- a) **Allocation Years:** 2013-14 through and including 2017-18.
- b) **Applicable Tax Years:** After 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 19.5% of the tax credits to small businesses. Relative to the number of taxpayers receiving credits, 38.7% 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, those that applied for credits, the mean average credit award, and the median average credit award.

As of November 2017	Number of Awardees	Number of Jobs Committed	Amount of Investment Committed	Credit Awarded
Non-Small Businesses	530	72,822	\$14,716,822,865	\$503,242,528
Small Businesses	335	10,590	\$1,883,098,300	\$121,670,456
Total Businesses	865	83,412	\$16,599,921,165	\$624,912,984

Fiscal Year	Total Credit Available	Total Credit Requested	Number of Non-Small Business Applications	Number of Small Business Applications	Number of Non-Small Businesses Awarded	Number of Small Businesses Awarded
2013-2014	\$30,000,000	\$561,454,983	262	134	18	11
2014-2015	\$151,100,000	\$939,315,673	592	214	135	77
2015-2016	\$200,900,000	\$808,851,620	568	328	171	88
2016-2017	\$243,300,000	\$1,106,097,690	621	324	158	117
2017-2018*	\$230,400,000	\$349,443,115	261	84	48	42

As of November 2017	Average Cost Per Job	Average Amount of Investment Committed Per Credit Awarded	Mean Average Credit Award	Median Average Credit Award
Non-Small Businesses	\$6,911	\$29	\$949,514	\$377,500
Small Businesses	\$11,489	\$15	\$363,195	\$115,000
Total Businesses	\$7,492	\$27	\$722,443	\$250,000

- 4) **Credit Utilization:** Under the California Competes Tax Credit Agreement, the taxpayer agrees to annually report to GO-Biz as to whether they have met their employment and/or investment milestones. If the business has met or exceeded its commitment, the taxpayer is allowed to claim the credit. If tax liability is less than the value of the credit, the taxpayer is allowed to carryforward the value of the unused portion of the credit.

In cases where the taxpayer is not able to meet the milestone, the tax payer can meet the employment and/or investment commitment in a subsequent year. When significant issues occur, such as bankruptcies, the taxpayer and GO-Biz may mutually agree to end the agreement, and those credits would then be considered "recaptured" and be available for reallocation.

Recaptured credits are not affected by the annual allocation limit in statute but are impacted by the \$750 million cap on applied credits. GO-Biz reports that as of November 2017, \$13.6 million in credits have been recaptured from 33 agreements.

As noted previously, utilization of the California Competes Tax Credit is lower than expected. The chart below shows data from the Franchise Tax Board and GO-Biz on utilization of the tax credit and recaptured credits.

California Competes Utilization 2014 through 2017				
Tax Year	Net Amount of Credit Eligible	Utilization by Dollar	Utilization by Number of Returns	Recaptured Credits by Dollar
2014	\$10.3 million	\$4.3 million	87	\$250,000
2015	\$37.9 million	\$13.1 million	306	\$2.5 million
2016	\$60.0 million	\$18.7 million*	465*	\$2.8 million
2017	Not Available	Not Available	Not Available	Not Available
*Preliminary number, not all fiscal-year filers				
Source: Franchise Tax Board and GO-Biz				

- 5) **Oversight Hearings:** The Assembly Committee on Jobs, Economic Development, and the Economy (JEDE) held comprehensive oversight hearings on GO-Biz programs, including the California Competes Tax Credit, in 2016. Materials available: <http://ajed.assembly.ca.gov/content/web-briefing> Issues raised in these hearings were addressed by GO-Biz through administrative action and two JEDE sponsored bills, one in 2016 (enacted) and another in 2017 (pending in the Senate).

The first bill, AB 2900 (JEDE), increased reporting and tracking to provide greater transparency to how the tax credit was meeting its small business and program priority of awarding credits to projects and businesses located or proposed to be located in an area of high unemployment or high poverty; *AB 2900 (JEDE), Chapter 582, Statutes of 2017.*

The second bill, AB 162 (Cervantes and Quirk-Silva), modifies the definition of small business to better align the program with businesses that may be able to utilize the credit. As many small businesses, including start-ups, have limited tax liability, other types of business incentives are more applicable, such as small business technical assistance.

Remaining outstanding issues from the oversight hearings include:

- Providing a clear statement of the purpose of the California Competes Tax Credit and related metrics for evaluating that purpose;
- Addressing the low utilization rate, including saleable or transferable credits; and
- Determining a method for using the program to assist California communities in competing with other states in attracting and retaining large, regionally significant businesses.

AB 2312 addresses this third open item from the committee oversight hearings.

- 6) **Governor's Proposed Budget 2018-19:** The Governor's proposed budget for fiscal year 2018-19 includes a legislative proposal to extend the California Competes Tax Credit for an additional five years by extending the allocation authority from June 30, 2018 to June 30, 2023.

In addition to extending tax credit allocation authority, the Governor is proposing to reduce the overall value of the annual tax credit awards from \$200 million per year to \$180 million per year and to remove the mandate to annually set aside 25% of allowable awards to taxpayers who meet the requirements of being a small business.

In 2016-17, \$27.3 million in allocated credits from the small business set-aside was carried forward to California Competes' final year, resulting in \$77.3 million in available small business credits. If unallocated, these credits would be carried forward to 2018-19 and, under the terms of AB 2312, one-half could be available for a preliminary allocation.

In a separate but related budget proposal, the Governor is proposing a five-year commitment of \$20 million per year for small business technical assistance. AB 2463 (Quirk-Silva and Cervantes), sponsored by GO-Biz, establishes the California Small Business Assistance Program, which would provide grants to federally designated small business technical assistance centers, including Small Business Development Centers, Women's Business Centers, Minority Business Development Centers, Veteran Business Outreach Centers, Procurement Technical Assistance Centers, and the Manufacturing Extension Partnership.

The Governor's \$20 million budget proposal is designed to capitalize the California Small Business Assistance Program. AB 2643 is also scheduled to be heard in the Assembly Committee on Jobs, Economic Development, and the Economy on April 17, 2018.

- 7) **LAO Report:** The Legislative Analyst's Office issued a report on the California Competes Tax Credit in October 2017 and later issued a related "Budget and Policy Post." Among other findings, the LAO report and web-posting:
- Concluded that the executive branch has made a good faith effort to implement California Competes;
 - Found that about 35% of the total number of awards (about 15% of the dollar value) were awarded to businesses in the "non-tradable" sector of the state's economy;
 - Found that even though GO-Biz had undertaken extensive outreach, the 25% small business set-aside was being significantly underutilized;
 - Expressed concern that programs like California Competes have inherent and unavoidable risks of "providing windfall benefits or awards to businesses in the non-tradable sector of the economy" and can result in "significant tax burden disparities among similarly situated taxpayers" by providing a "substantial benefit to a relatively small number of the hundreds of thousands of businesses here."

Overall, the LAO recommends rejecting the Governor's proposed extension of the California Competes Tax Credit. If extended, the LAO recommends:

- Clarifying the intent of the tax credit especially as its purpose relates to attracting and retaining employers;

- Narrowly focusing the program on tradeable businesses; and
- Eliminating the small business set-aside.

There appears to be broad support for defining a clear purpose to the California Competes Tax Credit. Ensuring that there is an alignment between that purpose and the structure of the tax credit may be more challenging. AB 2312 does provide one method for helping local California communities compete for manufacturing jobs, which is considered a tradable industry sector. Further program adjustments may also need to be made.

- 8) **Proposed Amendments:** The Committee may wish to consider the following amendments:
- a) Expand the authority to award preliminary tax credit awards from solely manufacturing to include manufacturing, research and development, testing facilities, and corporate headquarters;
 - b) Limit preliminary tax credit awards for retention to only those instances where an existing facility or headquarters is under consideration for being purchased;
 - c) Define regionally significant projects as directly impacting more than 150 jobs in an eligible business activity;
 - d) Require GO-Biz to identify eligible manufacturing, research and development, and testing facilities from within specific NACIS codes;
 - e) Include recaptured credits within the 50% calculation for eligible credits available for preliminary awards through local government applicants; and
 - f) Revise the legislative intent to conform to other subdivisions in the same sections.
- 9) **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 to 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 162 (Cervantes and Quirk-Silva) California Competes Tax Credit – Small Business:*** This bill expands the definition of a small business under the California Competes Tax Credit Program from being a business with less than \$3 million in gross revenues in the preceding two years to being a business with no more than 50 full-time employees in the current and preceding two years. Status: Pending in the Senate Committee on Government and Finance.

- d) **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.*
- e) **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.
- f) **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."*
- g) **AB 2900 (JEDE) Small Business Centers Reporting:** 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.
- h) **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.
- i) **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.
- j) **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.
- 10) **Double Referral:** The Assembly Rules Committee has referred this measure to the Assembly Committee on Jobs, Economic Development, and the Economy and to the Assembly Committee on Revenue and Taxation. Should this measure pass the committee, it will be referred to R&T for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

None Received

Opposition

None Received

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