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EXTERNAL UPDATE

# California: AB 93 Eliminates Current Enterprise Zone Program and Creates New Economic Development Incentives and a Partial Sales Tax Exemption for Manufacturers

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## Overview

On July 11, 2013, California Governor Edmund G. Brown Jr. signed Assembly Bill ("AB") 93, which phases out and replaces California Enterprise Zone ("EZ") tax credits with a new economic development program comprised of a hiring tax credit, a statewide partial sales and use tax manufacturing exemption, and incentive fund.[1] AB 93 takes effect immediately. California's current EZ program offers income tax credits to taxpayers located within specific geographic areas called EZ's. Under AB 93, the EZ incentives will be repealed as of January 1, 2014, and replaced by three new incentives.[2] This Tax Alert provides a summary of AB 93 and the new incentives, information on the treatment of EZ credits, both currently generated and carry-forward tax credits, and addresses other possible taxpayer considerations.

## Summary of AB 93

AB 93 phases out the current California EZ program and replaces it with three new incentives:

1. A hiring credit under the Personal Income Tax ("PIT") and the Corporation Tax ("CT") for the hiring of certain qualified employees by taxpayers located in certain current EZ's along with certain census tracts that will be designated.[3]
2. A 4.19% statewide sales and use tax exemption for manufacturing and biotechnology equipment, including research and development equipment.[4]
3. A negotiated incentive fund, administered by the Governor's Office of Business and Economic Development ("GO-Biz"), to provide tax credits for purposes of retaining existing and attracting new business activity throughout California.

*Hiring Credit*

AB 93 includes a new hiring credit that can be used to offset California PIT and/or CT from January 1, 2014 through December 31, 2020. To qualify for the hiring credit, a qualified business must have a net increase in jobs, hire qualified full-time employees, and be located in either a designated census tract that will be comprised of those census tracts with the highest 25 percent of state

[1] AB 93 (enrolled July 3, 2013) 2013-14 Leg., (Cal. 2013). Governor Brown also signed Senate Bill ("SB") 90 on July 11, 2013. 2013-14 Leg., (Cal. 2013). SB 90 modifies some provisions of AB 93. This Tax Alert incorporates the changes made by SB 90 into the discussion of AB 93.
[2] AB 93 also phases out and ends on December 31, 2013, the current "new jobs credit" in California, as well as California credits associated with Local Area Military Base Relocation Areas ("LAMBRA"), Manufacturing Enhancement Areas ("MEA") and Targeted Tax Areas ("TTA").
[3] SB 90, Sections 2 and 4, amending Cal. Rev. & Tax. Code §§ 17053.73 (for individual taxpayers) and 23626 (for corporate taxpayers) as added by AB 93 Sections 13 and 33.
[4] SB 90, Section 1, amending Cal. Rev. & Tax. Code § 6377.1 as added by AB 93, Section 6. The 4.19% is comprised of the tax levied pursuant to Rev & Tax Code §§ 6051, 6051.3, 6201 and 6201.3 (3.94%) and the 0.25% rate pursuant to Section 36, Article XIII. The exemption does not apply to county, city or district taxes

unemployment and poverty rates (based on US Census tracts) or within an economic development area.[5] An economic development area is defined as either a former enterprise zone (excluding census tracts determined to be wealthy) or a local agency military base recovery area ("LAMBRA").[6]

The measure of the credit for businesses located in designated census tracts or economic development areas will be qualified employees' wages between 150% and 350% of minimum wage, which is currently between $12 and $28 per hour.[7] For businesses located in a designated pilot area, the measure of the credit will be the portion of wages between $10 per hour and 350% of minimum wage.[8] GO-Biz may designate up to five designated pilot areas (which can each contain five or fewer census tracts) located within designated census tracts or economic development zones.[9] Only census tracts with average wages less than the statewide average and high poverty or unemployment may be included in designated pilot areas.[10] To the extent the hiring credit generated exceeds the "net tax" liability of the taxpayer, the credit may be carried over for up to 5 years.[11]

The hiring credit may be available to qualified taxpayers hiring individuals meeting one of five criteria:

i. A person who was unemployed for six months or more before the commencement of employment,[12]
ii. A veteran who separated from service in the United States Armed Forces within the 12 months before the commencement of employment,[13]
iii. A person who was a recipient of the federal Earned Income Tax Credit in the previous tax year,[14]
iv. Ex-offenders previously convicted of a felony, or[15]
v. Recipients of CalWorks or General Assistance.[16]

In addition to meeting one of the criteria above, a qualified full-time employee must also receive wages that are at least 150 percent of the minimum wage and work more than an average of 35 hours per week if paid hourly or be a salaried employee on a full-time basis.[17]

Certain businesses (excluding small businesses with receipts of less than 2 million dollars) are expressly excluded from the definition of qualified taxpayer for purposes of claiming the hiring credit, including temporary help services, retail trade services, retail food services, bars, sexually oriented businesses, casinos and casino hotels.[18]

AB 93 also imposes several other restrictions on claiming the hiring credit, including:

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[5] SB 90, Sections 2 and 4, amending Cal. Rev. & Tax. Code §§ 17053.73 (a) and (b) (for individual taxpayers) and 23626 (a) and (b) (for corporate taxpayers) as added by AB 93 Sections 13 and 33.
[6] SB 90, Sections 2 and 4, amending Cal. Rev. & Tax. Code §§ 17053.73(b)(8) (for individual taxpayers) and 23626(b)(8) (for corporate taxpayers) as added by AB 93 Sections 13 and 33.
[7] SB 90, Sections 2 and 4, amending Cal. Rev. & Tax. Code §§ 17053.73(b)(12)(A)(i) (for individual taxpayers) and 23626(b)(12)(A)(i) (for corporate taxpayers) as added by AB 93 Sections 13 and 33.
[8] SB 90, Sections 2 and 4, adding Cal. Rev. & Tax. Code §§ 17053.73(b)(12)(A)(ii)(I) (for individual taxpayers) and 23626(b)(12)(A)(ii)(I) (for corporate taxpayers).
[9] SB 90, Sections 2 and 4, adding Cal. Rev. & Tax Code §§ 17053.73(b)(12)(ii)(II) and (III) (for individual taxpayers) and 23626(b)(12)(ii)(II) and (III) (for corporate taxpayers).
[10] SB 90, Sections 2 and 4, adding Cal. Rev. & Tax Code §§ 17053.73(b)(12)(ii)(II)(ac) (for individual taxpayers) and 23626(b)(12)(ii)(II)(ac) (for corporate taxpayers).
[11] AB 93, Sections 13 and 33, adopting new Cal. Rev. & Tax. Code §§ 17053.73(k) (for individual taxpayers) and 23626(j) (for corporate taxpayers).
[12] AB 93, Sections 13 and 33, adopting new Cal. Rev. & Tax. Code §§ 17053.73(b)(10)(A)(vi)(I) (for individual taxpayers) and 23626(b)(10)(A)(vi)(I) (for corporate taxpayers).
[13] SB 90, Sections 2 and 4, amending Cal. Rev. & Tax. Code §§ 17053.73(b)(10)(A)(vi)(II) (for individual taxpayers) and 23626(b)(10)(A)(vi)(II) (for corporate taxpayers) as added by AB 93 Sections 13 and 33.
[14] AB 93, Sections 13 and 33, adding Cal. Rev. & Tax. Code §§ 17053.73(b)(10)(A)(vi)(III) (for individual taxpayers) and 23626(b)(10)(A)(vi)(III) (for corporate taxpayers).
[15] SB 90, Sections 2 and 4, adding Cal. Rev. & Tax. Code §§ 17053.73(b)(10)(A)(vi)(IV) (for individual taxpayers) and 23626(b)(10)(A)(vi)(IV) (for corporate taxpayers) as added by AB 93 Sections 13 and 33.
[16] SB 90, Sections 2 and 4, adding Cal. Rev. & Tax. Code §§ 17053.73(b)(10)(A)(vi)(V) (for individual taxpayers) and 23626(b)(10)(A)(vi)(V) (for corporate taxpayers).
[17] AB 93, Sections 13 and 33, adding Cal. Rev. & Tax. Code §§ 17053.73(b)(10)(A)(ii) and (v) (for individual taxpayers) and 23626(b)(10)(A)(ii) and (v) (for corporate taxpayers).
[18] SB 90, Sections 2 and 4, adding Cal. Rev. & Tax. Code §§ 17053.73(b)(11)(C) (for individual taxpayers) and 23626(b)(11)(C) (for corporate taxpayers) as added by AB 93 Sections 13 and 33.

- The hiring credit must be claimed on an original tax return[19]
- To obtain the hiring credit, a qualified taxpayer must request a tentative credit reservation with the Franchise Tax Board within 30 days of complying with the Employment Development Department's new hire reporting requirements[20]
- A qualified taxpayer will need to provide a certification to the FTB annually as to whether a previously qualified employee remained employed or was terminated in the prior tax year[21]
- If a qualified employee is terminated by an employer prior to 36 months after hire, recapture may apply unless certain circumstances are present[22]

*Statewide Sales and Use Tax Exemption for Manufacturing and Research and Development*

Beginning for purchases on July 1, 2014, AB 93 provides an exemption for a portion of the state share of the sales and use tax – 4.19% – for business purchases of qualified tangible personal property by a qualified person.[23] A qualified person is one engaged in those lines of business described in Codes 3111-3399, and 541711 and 541712 in the 2012 edition of the North American Industry Classification System ("NAICS"). The NAICS code range 3111 through 3399 encompasses a large portion of the manufacturing sector. It is generally comprised of establishments engaged in the transformation of raw materials into new products. NAICS codes 541711 and 541712 describe research and development in biotechnology and life sciences, respectively.

Qualified property includes but is not limited to machinery and equipment with a useful life greater than one year, used primarily in manufacturing, processing, fabricating, refining or recycling of tangible personal property, as well as research and development, anywhere in California.[24] For purposes of this exemption "primarily" means that the property must be used 50% or more of the time in any stage of the process. The 4.19% exemption applies to the first $200 million in qualified property purchases made in a calendar year by a qualified taxpayer.[25] The exemption also applies to, otherwise qualified purchases by a construction contractor.[26]

In the event otherwise qualifying purchases are removed from the state or converted to an unqualified use within one year of the purchase, or the $200 million annual threshold is exceeded, the exemption does not apply to such purchases.[27] The purchaser must furnish the retailer with an exemption certificate.[28]

The exemption sunsets June 30, 2022.

*Negotiated Incentives*

Finally, AB 93 provides for a competitive negotiated incentive that will be awarded to taxpayers who apply. The income or corporate tax credit will be called the California Competes Tax Credit ("CCTC"). The CCTC will be administered by GO-Biz and the availability of the incentive will be subject to a competitive application process.

The amount of CCTC incentives available to GO-Biz under AB 93 will be: [29]

- $30 million for fiscal year 2013 – 2014
- $150 million for fiscal year 2014 – 2015
- $200 million for each fiscal year 2015 – 2016 through 2017 – 2018.

The CCTC will include a set aside of 25% for small businesses and a provision that no single

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[19] AB 93, Sections 13 and 33, adding Cal. Rev. & Tax. Code §§ 17053.73(a)(4) (for individual taxpayers) and 23626(a)(4) (for corporate taxpayers).
[20] AB 93, Sections 13 and 33, adding Cal. Rev. & Tax. Code §§ 17053.73(e)(1) (for individual taxpayers) and 23626(e)(1) (for corporate taxpayers).
[21] AB 93, Sections 13 and 33, adding Cal. Rev. & Tax. Code §§ 17053.73(e)(3) (for individual taxpayers) and 23626(e)(3) (for corporate taxpayers).
[22] AB 93, Sections 13 and 33, adding Cal. Rev. & Tax. Code §§ 17053.73(i) (for individual taxpayers) and 23626(i) (for corporate taxpayers).
[23] SB 90, Section 1, amending the effective date of Cal. Rev. & Tax. Code § 6377.1(a) as added by AB 93 Section 6.
[24] AB 93, Section 6, adding Cal. Rev. & Tax. Code § 6377.1(a)(1) and (b).
[25] AB 93, Section 6, adding Cal. Rev. & Tax. Code § 6377.1 (e)(1)(A).
[26] AB 93, Section 6, adding Cal. Rev & Tax Code §6377.1(a)(2)(D).
[27] AB 93, Section 6, adding Cal. Rev. & Tax. Code § 6377.1(e).
[28] AB 93, Section 6, adding new Cal. Rev. & Tax. Code § 6377.1(c).
[29] SB 90, Sections 3 and 5, amending Cal. Rev. & Tax. Code §§ 17059.2(g) (for individual taxpayers) and 23689(g) (for corporate taxpayers) as added by AB 93 Sections 18 and 38.

taxpayer can receive more than 20% of the funds available to GO-Biz.[30]

Factors to be considered by GO-Biz in the decision to award credits to a taxpayer will include:

- The number of jobs the taxpayer will create or retain in the state;
- Compensation paid or proposed to be paid to its employees;
- Amount of investment by the taxpayer;
- Extent of unemployment or poverty in the area;
- Other incentives available to the taxpayer in this state and other states;
- Duration of the proposed project and commitment of taxpayer to remain in the state;
- Overall economic impact of the project or business;
- Strategic importance of taxpayer's project or business to the state, region, or locality;
- Opportunity for future growth and expansion in the state; and
- The extent to which the anticipated benefit to the state exceeds the projected benefit to the taxpayer from the tax credit.[31]

All CCTC awards will be made publicly available upon approval.[32]

Resulting written agreements between taxpayers and GO-Biz shall include provisions related to minimum employee compensation and an employee retention period, credit allocation details, and provisions allowing recapture of the credit, in whole or in part, if the taxpayer fails to fulfill the terms of the agreement.[33] To the extent credit received under the agreement exceeds the "net tax" liability of the taxpayer, excess credit may be carried over for up to six years.[34]

Written agreements between the taxpayer and GO-Biz must be approved by the California Competes Tax Credit Committee, whose members will include the Treasurer, the Director of Finance, the Director of GO-Biz, and an appointee by the Assembly and the Senate.[35]

### Current EZ Credits and Carry-forward Amounts

AB 93 phases out the current EZ program and ends the ability to generate new EZ credits for tax years beginning on or after January 1, 2014.[36] Until December 31, 2013, the applicable EZ credits and rules will still apply. EZ credit carry-forwards generated prior to January 1, 2014 shall be allowed for 10 years.[37] The 10 year carry-forward provision is also applicable to hiring or sales and use tax credits generated under the LAMBRA, Targeted Tax Area, or Manufacturing Enhancement Area programs.[38] The EZ hiring credit will remain operative for qualified employees hired by a qualified taxpayer before January 1, 2014, and qualified wages paid to qualified employees used to generate EZ credits may continue for the 60-month period following the date of hire.[39]

Note that the reduction of the EZ carry-forward period to ten years under AB 93 may significantly impact taxpayers with large credit carry-forwards. Taxpayers may or may not have analyzed current EZ carry-forwards for purposes of a valuation allowance. With the reduction of the carry-forward period from an indefinite to a fixed 10-year period, the need to review future credit utilization for purposes of a valuation allowance may become more immediate.

### Taxpayer Considerations

Taxpayers preparing to file their 2012 California corporate franchise tax returns who currently claim

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[30] AB 93, Sections 18 and 38, adding Cal. Rev. & Tax. Code §§ 17059.2(g)(2) and (g)(3) (for individual taxpayers) and 23689(g)(2) and (g)(3) (for corporate taxpayers).
[31] AB 93, Sections 18 and 38, adding Cal. Rev. & Tax. Code §§ 17059.2(g)(2)(A)-(K) (for individual taxpayers) and 23689(g)(2)(A)-(K) (for corporate taxpayers).
[32] AB 93, Sections 18 and 38, adding Cal. Rev. & Tax. Code §§ 17059.2(c)(6) (for individual taxpayers) and 23689(c)(6) (for corporate taxpayers).
[33] AB 93, Sections 18 and 38, adding Cal. Rev. & Tax. Code §§ 17059.2(a)(3) (for individual taxpayers) and 23689(a)(3) (for corporate taxpayers).
[34] AB 93, Sections 18 and 38, adding Cal. Rev. & Tax. Code §§ 17059.2(e) (for individual taxpayers) and 23689(e) (for corporate taxpayers).
[35] AB 93, Section 26, adding Cal. Rev. & Tax. Code § 18410.2(a).
[36] AB 93, Sections 14 and 29, adding Cal. Rev. & Tax. Code §§ 17053.74(l)(1) (for individual taxpayers) and 23622.7(l)(1) (for corporate taxpayers).
[37] SB 90, Section 6.
[38] *Id*.
[39] AB 93, Sections 14 and 29, adding Cal. Rev. & Tax. Code §§ 17053.74(l)(2) (for individual taxpayers) and 23622.7(l)(2) (for corporate taxpayers).

EZ credits should determine the extent to which AB 93 will affect their ability to generate future credits as well as carry-forward related issues. For taxpayers located in a designated census tract, planning for AB 93 should be considered as soon as possible. For taxpayers located throughout the State, careful consideration should be given to whether they qualify for the sales tax exemption. Further, taxpayers located throughout the State who are considering expansion and/or new capital investment in California in 2013 and/or 2014 should carefully consider the effect of AB 93 and whether the CCTC may prove beneficial.

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