

Enterprise Zones

Investment Incentives Can Encourage Economic Development in State

Summary

Background

California's enterprise zone (EZ) program offers the state's most significant economic development tax incentives, broadly applying to businesses of all sizes across virtually all industry lines. The EZ program was established by California Chamber of Commerce-supported legislation signed in 1984 and offers a variety of tax credits and incentives to encourage businesses to locate, invest and create jobs in economically distressed communities within the state. Both EZ companies and employees may be eligible for benefits under the program, including:

- Hiring credits: Companies can earn \$35,600 or more in state tax credits for each qualified employee hired over a five-year period (up to \$11,700 during the first 12-month employment period).
- Worker credits: Employees can qualify for a one-time individual employee credit of up to \$525.
- Equipment credits: Subchapter C corporations can earn sales tax credits on purchases of up to \$20 million (\$1 million for S corporations, partnerships and LLCs) per year for qualified machinery and machinery parts, including manufacturing, processing, research and development, and pollution control equipment used exclusively in an EZ.
- Tax deduction: Lenders to EZ companies may receive an income tax deduction for the net interest income earned on EZ loans.
- Preference points: EZ companies can earn preference points on state contracts.

State Policy

California's EZ program not only breathes economic life into distressed areas, but also helps California compete for jobs with other states and countries. The program is one of the only remaining statewide tax incentives that local areas can use to encourage businesses to stay, locate or expand within California. Current law allows for 42 enterprise zones. Communities apply for and receive EZ designations from the state through a competitive process. Several recent studies have established the program's effectiveness:

- An August 2006 study commissioned by the California Housing and Community Development Department documented the success of enterprise zones in spurring economic recovery, showing that from 1990-2000, compared to the rest of California, enterprise zones on average experienced:
 - ✓ Poverty rates 7.35 percent lower than the rest of the state.
 - ✓ Household incomes 7.1 percent higher.
 - ✓ Salary income 3.5 percent higher.
 - ✓ Median rents 2.3 percent higher.
- Another 2006 study from the University of California, Davis, conducted by Dr. Ted Bradshaw, described California's EZ program as "probably the most successful in the nation" — adding nearly 300,000 jobs to California from 1992-2002. The study confirmed that employment in the zones grew at almost double the rate of the rest of the state, and that tax collections generated by enterprise zones exceeded their cost. The study noted that problems in the program, such as inadequate oversight, were being addressed at the regulatory level by the Housing and Community Development Department.

The study emphasized that the cost of the California EZ program is not high in comparison to the returns. For example, Alabama offered Mercedes \$253 million in incentives to locate one plant in its state and create 1,500 jobs at an average cost of \$168,000 each, unlikely to be recovered by the state. By contrast, California's EZ program costs "only slightly more than this one recruitment effort, and yet it is a key part in a massive statewide job expansion involving tens of thousands of jobs per year."

- Yet another national study published by Drs. Ayse Imrohoroglu and Charles Swenson with the University of Southern California in February 2007 concluded that census tracts designated as EZs experienced larger declines in unemployment and poverty rates compared to the areas surrounding them, or compared to the areas that had similar unemployment and poverty rates. In addition, there was a marked change in unemployment and poverty levels in the EZ-designated census tracts following their designations as EZs.

Recent Legislative Developments

As part of the 2008-09 budget, California imposed a significant two-year limitation on the ability to use the EZ credit. AB 1452 (Committee on Budget) caps all business credits at half the

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taxpayer's tax liability. The EZ credit, along with the state's research and development credit, are the state's two most significant statewide business tax credits. The estimated loss to businesses due to the limit on the business credits is \$900 million.

The 2008-09 budget legislation provided an offsetting improvement to businesses by allowing for sharing of tax credits within the same family of companies (unitary utilization), effective January 2010. Few companies relying on EZ credits will benefit, however, because it is useful only to those having more than one location in the same EZ, and few companies do. To be truly helpful, unitary utilization would, at a minimum, need to be allowed among a family of companies located within different EZs.

Anticipated Action

The CalChamber will continue to promote improvements to the EZ program over the long term that will make it a more powerful local economic development tool to attract new businesses to California communities and encourage existing businesses to stay and expand within these communities. Examples of such improvements include:

- Removing the discrepancy in current law that causes companies to lose tax credits if they choose to focus their new equipment expenditures in a single year rather than dividing them over a number of years. Current law caps the sales and use tax credit on purchases of equipment to be used in an EZ at \$20 million per year for Subchapter C corporate taxpayers and \$1 million for other taxpayers. Qualifying equipment includes that used for manufacturing, renewable energy production, pollution reduction and motion picture production. The problem with the current per-year caps is they penalize companies that want to make large investments in a single year.
- Applying the \$20 million cap uniformly to all business entities, not just those that pay the corporate tax. Currently, entities such as LLCs and partnerships are subject to a \$1 million cap (20 times less than the C corporation limit) even though their owners may actually be subjected to higher rates than a C corporation. The law should not favor one type of business entity over another. This inequity may discourage some companies from locating significant new operations within an EZ.
- Exploring how the EZ program can facilitate other state goals, such as alleviating infrastructure costs and incentivizing businesses with heavy industries to purchase recycling, energy and pollution control equipment.

CalChamber Position

The CalChamber opposes any attempt to undermine or reduce the EZ program and supports changes to the enterprise zone program that will improve or strengthen the economic development incentives under the program.

Reason for Position

The program is one of the only remaining statewide tax incentives that local areas can use to encourage businesses to stay, locate or expand within California.

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