

Enterprise Zones and Proposed Administrative Reforms
FEBRUARY 2013

SDCTA Position: Support Enterprise Zones

Oppose proposed administrative reforms as currently written and provide recommendations for improving accountability without significantly lessening the effectiveness of the Enterprise Zone program.

SDCTA Recommended Amendments:

Amend the proposed regulations to:

- Make the period for applying for vouchers at least two years or provide the ability for those with intent to apply to request an extension
- Maintain the ability for an employee to receive a voucher based on income level alone
- Maintain the option to use the California median income as a comparison point for a census tract to qualify to be part of a Target Employment Area (TEA)

Title: Enterprise Zones and Administrative Reforms of Enterprise Zones

Jurisdiction: State

Type: N/A

Vote: N/A

Status: Public comment period open until February 28

Issue: Areas in California are economically blighted and depressed. Enterprise Zone tax credits may not all be directly contributing to the goal of the program, and limited data is available to study its effectiveness.

Description: The stated purpose of the Enterprise Zone Act of 1984 is “to stimulate business and industrial growth in the depressed areas of the State”. To accomplish this goal, the Enterprise Zone program offers benefits to qualified employers doing business within designated Enterprise Zones. The degree to which fraud and abuse exists in the program, and retroactive benefits are provided, economic development benefits are not being achieved by the tax credits. Critics argue that many of the reforms would make the program less effective by limiting participation.

Fiscal Impact: The immediate net fiscal impact of the program on the state is unclear because of the possibility that increases in revenue from within Enterprise Zones may be offset by decreases in revenue from areas outside of Enterprise Zones. According to the State Fiscal Year 2013-2014 budget proposed by Governor Brown, “The regulations, in total, are expected to increase General Fund revenue by \$10 million in 2012-13 and \$50 million in 2013-14.”

Rationale for Position:

With California having relatively high corporate, personal income, and sales tax rates in addition to a high average cost of living, the Enterprise Zone program is one of the few economic development tools available to attract, retain, and expand local businesses. SDCTA supports Enterprise Zones and several of the currently proposed amendments that limit abuse and increase the effectiveness of the program.

As written, the proposed administrative reforms create much needed accountability measures that would only be able to measure the decreased effectiveness of a diluted program. The proposed reforms effectively eliminate the “Economically Disadvantaged” category that currently provides incentives for hiring the poor, and lessens the window for businesses to apply for tax credits to an unnecessarily short period. SDCTA believes the Association’s recommended amendments to the proposed reforms will allow the program to continue to target the “working poor” while largely maintaining the effectiveness of the program and increasing accountability and transparency.

Background:

History

Established under the Enterprise Zone Act of 1984, the California Enterprise Zone program offers tax credits and other incentives to businesses that locate and invest in economically blighted areas of the state, with the goal of creating jobs and spurring growth in these regions. Communities may submit applications for designation as an enterprise zone to the California Department of Housing and Community Development, which determines whether the economic conditions in a community are sufficiently depressed to warrant designation as an Enterprise Zone.

There is a limit designated by legislation of 42 enterprise zones within the state. Two zones recently expired - Antelope Valley and Watson. There are now 40 Enterprise Zones located across the State of California (See Appendix A). San Diego County was home to two Enterprise Zones—the Metro EZ and the South Bay EZ—until 2006 when they were combined and expanded to form the 34,720 acre San Diego Regional Enterprise Zone. The one Regional Enterprise Zone incorporated areas of the City of San Diego including portions of Downtown, Barrio Logan, North Park, City Heights, Otay Mesa and San Ysidro as well as portions of Chula Vista and National City.

The Enterprise Zone program nearly ended in 2011 when Governor Jerry Brown eliminated tax credits for Enterprise Zone businesses from his January budget proposal in an attempt to raise revenue. After considerable protest by Enterprise Zone supporters, the Governor scaled back cuts to the program in his May 2011 Budget Revise. Ultimately, the Enterprise Zone program was left intact without reforms because as a tax issue, most changes to the program would have required a two thirds majority vote in both houses of the state legislature. Alternatively, some reforms could be made administratively, which is expected to be explored as an option in the coming months.

In September of 2012, additional acreage was added to the zone. The expansions included areas along the U.S. – Mexico border, and as far north of the Interstate-8 freeway as Mira Mesa and Rancho Bernardo. Because an Enterprise Zone can only grow in size by 15

percent of the original acreage, and an area cannot be excluded once it is part of an Enterprise Zone, the Regional Enterprise Zone strategically added only limited areas.¹ The newly added areas are zoned commercial and industrial and are consistent with economic strategies including the City of San Diego's goal of creating relatively well paying manufacturing jobs.

Existing Law

The stated purpose of the Enterprise Zone Act of 1984 is "to stimulate business and industrial growth in the depressed areas of the State". To accomplish this goal, the Enterprise Zone program offers the following benefits to qualified employers doing business within designated Enterprise Zones²:

- Receive a tax credit equivalent to the amount of sales tax on new manufacturing, assembly, data processing, or communications equipment purchased, or up to \$1.55 million annually.
- Receive a hiring tax credit on the wages of qualified new employees of up to \$37,000 per employee over a five year period (See Appendix B).
- The option to treat 40% of the cost of qualified property as a business expense in the first year of use for a maximum deduction of \$20,000 per year as well as the ability of lenders to deduct net interest earned from loans made to Enterprise Zone businesses.
- The City of San Diego provides several benefits unique to the San Diego Regional Enterprise Zone including an expedited development permit process and a no-cost job referral service to help businesses find qualified employees.

In order to receive hiring tax credits, employers must hire individuals that meet certain criteria and must retain the employees for at least 270 days of employment or 90 days of employment plus 270 calendar days.

A qualified employee is one who fits into one of several specified categories such as:³

- Chronically unemployed, including individuals at least 55 years of age who may have substantial barriers to employment by reason of age.
- Involuntarily separated from the armed forces following active military duty, or a disabled veteran.
- Unemployed due to a plant closure or substantial layoff.
- A chronically unemployed seasonal or migrant worker.
- A member of a federally recognized Indian Tribe or other group of Native American descent.
- An ex-offender.
- A resident of a federally defined "targeted employment area."
- A person eligible for services under the federal Job Training Partnership Act.

¹ Conversation with City of San Diego staff Lydia Moreno.

² The City of San Diego, www.sandiegoregionalez.org

³ Journal of Multistate Taxation and Incentives. Volume 17, Number 08, Nov/Dec 2007. "SBE Ruling Eases Requirements to Claim California Enterprise Zone Hiring Credit"

Additionally, at least 90 percent of the employee's work must be directly related to a trade or business activity located in the Enterprise Zone and at least half of the employee's work must be performed within the boundaries of the Enterprise Zone⁴.

Current reporting and oversight requirements call for the governing board of each Geographically Targeted Economic Development Area (G-TEDA) to submit a biannual report to the Department of General Services the activities of the G-TEDA in the previous two fiscal years and its plans for the current and following fiscal year. Recent legislation such as Assembly Bill (AB) 2673 would have substantially increased these reporting requirements with the goal of increasing oversight and assessing the impact of the enterprise zone program.

SDCTA Past Position

None Known.

Proposal:

As discussed in the background section of this report, the Enterprise Zone program nearly ended in 2011 when Governor Jerry Brown eliminated tax credits for Enterprise Zone businesses during the budgeting process. Ultimately the Enterprise Zone program was left intact. Because eliminating or lessening most Enterprise Zone tax credits would constitute a tax increase, legislative reforms require a two thirds majority vote in both houses to comply with Proposition 26 (2010).

As an alternative, reforms are being proposed administratively, through the rule-making process. The State's Department of Housing and Community Development is responsible for the program, however the actual vouchers that allow employers to claim credits are issued by individual zones. The proposed regulation changes aim to streamline the vouchering process, eliminate retroactive vouchering, and increase reporting requirements to increase accountability, reduce fraud, and allow for more information to be available so that success can be better measured.⁵ The regulations additionally increase the application fee from \$10 to \$15.

"Streamlining"

The regulation changes propose to "streamline" the vouchering process by:

- changing the definition of "ex-Offender" to include those whose records have been expunged
- providing clarity with respect to:
 - the availability of vouchers for temporary worksites within the zone
 - the availability of vouchers for businesses that operate in an Enterprise Zone but are not headquartered there
 - the definition of 'employee' is that of common law
 - how Targeted Employment Areas are approved
 - eligibility for qualifying under the Disabled Individual Category

⁴ California Franchise Tax Board, Economic Development Areas Manual, P. 4

⁵ Initial Statement of Reasons. Enterprise Zone Program Regulations. January 2013.

- eliminating a requirement to have Workforce Investment Act (WIA) administrators verify age and veteran status and allowing the use of several other documents to support the vouchering of veterans

Eliminating Retroactive Benefits

The regulation changes propose to eliminate retroactive benefits by making “minor formatting changes.”⁶

Increasing Accountability

The regulation changes propose to increase accountability and make performance data available to the public by:

- no longer allowing employers to self-certify employee eligibility under the Targeted Employment Area (TEA) and Economically Disadvantaged categories
- changing the determination of Economically Disadvantaged Individual from using household income that is commonly not verified in practice, to third-party verification that the individual receives one of several public assistance benefits
- including in the voucher application fee process the periodic collection of vouchering statistics including standardizing the format and information to be collected
- removing department discretion regarding penalties by requiring a moratorium on expanding if reporting requirements are not met by an Enterprise Zone administrator
- creating a template and requiring use of it for voucher applications collecting more information, and reporting the collected data on the Housing and Community Development website including (but not limited to):
 - types of jobs (industry code)
 - salaries
 - hiring dates,
 - dates of termination
 - location of workplace
 - business age
 - business size
 - if the position is temporary
- requiring the name and signature of any third party application preparer
- creating a new template and requiring use of it for vouchers including specific information related to the employee and employer (including the basis of qualification) be included on the voucher itself to aid in voucher review and audits as well as requiring the application to be attached to the voucher itself
- clarifying the term “unlikely to return” with respect to terminations and lay-offs
- clarifying the term “substantial” with respect to plant closures and substantial layoffs
- the addition of Article 15 outlining how audits and monitoring will be used encourage compliance
- requires the State to develop a template and for Enterprise Zones to use the template to issue a report once every two years including maps in two formats, standardized

⁶ Initial Statement of Reasons. Enterprise Zone Program Regulations. January 2013.

reports, a program management report, and organization chart, zoning statistics and other specific information.

Policy Implications:

Impact of Proposed Regulation Changes

The proposed regulation changes are expected to significantly lower the amount of tax credits received by businesses. As with any elimination of an existing credit, companies that would have otherwise qualified for the credit will see higher taxes.

Effectively Eliminating the “Economically Disadvantaged” Category

Current regulations refer to both individual and household income with regards to qualification for the “Economically Disadvantaged” category. The Department of Housing and Community Development (HCD) has said that the intent was household income. In practice, household income has not been verifiable, and has therefore not regularly been used. The proposed revisions to the regulations would change this to individual income, but remove the most commonly used method of verification which is self-certification by the employer through hiring documents (e.g. I-9 or W-4).

The proposed replacements are documentation from public assistance programs leaving those who would qualify based on income level, but do not take advantage of public assistance programs out of luck.

Some have proposed that Enterprise Zone administrators should have access to the Federal Department of Housing and Urban Development’s (HUD) Employment Income Verification (EVI) Database. This database contains personal information and is used by the public housing agencies to verify income levels for other programs.

Eliminating Retroactivity

The proposed changes would only allow for the tax incentives to be provided for a 12 month period. HCD has provided the information that 30 percent of vouchers are submitted at least 24 months after the date of hire. HCD argues that there is not expected to be a substantial negative impact on hiring due to the elimination of retroactive hiring benefits as the credit is provided too late to be an effective hiring incentive.

The business community appears to believe that eliminating unlimited retroactivity would make the program stronger, however the 12 month period is believed to be an unreasonably short amount of time in which to expect businesses to collect the required paperwork. The business community seems to be proposing an 18 to 24 month timeframe at minimum.

Two legitimate reasons for maintaining a period longer than the proposed 12 month period are:

- A significant amount of hiring often occurs around the time a business opens its doors for the first time. It can be expected that the priority over the following 12 months would be to set up and refine operations for most businesses regardless of if the Enterprise Zone hiring credit played a part in incentivizing hiring.
- One way to qualify for a voucher is by receiving a Work Opportunity Tax Credit (WOTC) certificate. This must be applied for from the California Employment Development Department (EDD) within 28 days from the time of hire. Many who

use this certificate complain that it has been taking over a year to receive this certificate making it an unreliable for of certification for EZ purposes.

Redefining What Makes a Targeted Employment Area

According to the California Enterprise Zone Association, 79 percent of voucher applications are made on the basis of residency within a Targeted Employment Area (TEA). The current regulations require at least 51 percent of its census tract households to be below the household median income of either California or the County in which the census tract is.

By eliminating the State option, the proposed regulation changes the comparison point (that 51 percent of households have to fall below) for all Counties that have median incomes below that of the State. This does not impact San Diego County directly as a census tract that has 51 percent of households earning less than the State median income of \$61,632 (2011), would also be earning less than the San Diego County median income of \$63,857.⁷

This is not true for the more heavily agricultural counties such as Imperial County. Currently, a census tract in Imperial County can qualify as part of a TEA if 51 percent of households earning less than the State's median income of \$61,632. The proposed regulations removes the option of comparing to the State's median income and requires that 51 percent of households in a given census tract earn less than the County's median household income of \$39,402. Under current regulations, 83.9 percent of census tracts would qualify as a TEA. Under the proposed regulation, only 51.6 percent of census tracts would qualify.

Streamlining and Increasing Accountability

Any additional credits provided due to increased access through streamlining, to the degree it is successful, will provide positive impacts to EZ businesses due to the increased clarity and decreased burden of the application.

The effects of curbing fraud and abuse would allow the program to better achieve its goal of providing jobs to "hard-to-hire" individuals to the degree to which it is successful. Negative impacts would be felt by those businesses that are no longer determined to be supporting the intent of the law.

Statenside Impact of Enterprise Zones

The cost of the Enterprise Zone program amounted to \$250 million in 2002, while the estimated increase in income and sales taxes paid to the state as a result of Enterprise Zone benefits totaled \$400 million in the same year according to a 2011 study by the California Budget Project.

In terms of attaining its job creation goals, different studies have produced mixed evaluations of the program's success in spurring growth. A review of the Enterprise Zone program conducted by economist Ted K. Bradshaw of UC Davis shows that employment growth in enterprise zones outpaced California total employment growth over a ten year sample period⁸.

⁷ Census 2011 American Community Survey 5-year Estimate.

⁸ Bradshaw, Ted K., "How California's Enterprise Zones Have Saved the State From Decline" University of California, Davis. 2006 P. 3

On the other hand, a study conducted by the Public Policy Institute of California found that job growth in enterprise zones showed minimal differences from 1,000 foot “control rings” surrounding the Enterprise Zones⁹; however, this finding may be the result of a multiplier effect of an increase in the number of firms doing business in enterprise zones on smaller firms in the surrounding area. New firms have been shown to have a multiplier effect on growth in an area by providing increased business to the adjacent suppliers and service providers as well as through their employees’ spending.

Evidence suggests that while Enterprise Zone tax incentives do provide benefits to economically blighted areas, the improvements in these areas may be the result of capital flight from non-Enterprise Zone regions. A study of enterprise zones conducted by Nonprofit Management Solutions shows that 60.3 percent of new firms relocating in enterprise zones came from a non-Enterprise Zone area within the state of California, 35.2 percent simply moved from another Enterprise Zone area within the state, and just 4.5 percent came from out of state¹⁰.

Some research shows that large corporations claim the bulk of Enterprise Zone tax credits; however, this phenomenon may be attributable in part to the legal and clerical overhead involved in making such claims, which could deter small companies from pursuing them.

Enterprise zones seem to be effective in improving economic indicators such as property values and poverty rates. The California Housing and Community Development Department commissioned a 2006 study of the program finding that, compared to statewide numbers over the 1990s¹¹:

- Poverty rates fell 7.35 % in Enterprise Zones
- Median rents rose 2.3% in Enterprise Zones
- Household incomes rose 7.1% in Enterprise Zones

Local Impact of Enterprise Zones

The City of San Diego Economic Growth Services Department attributes the following to the Enterprise Zone program¹²:

- \$1.7 billion worth of investment has been made in San Diego enterprise zones.
- Over 20,000 jobs have been created in the region.
- Hundreds of local businesses have received expedited permit applications.
- Thousands more have received financial assistance.
- South Bay’s poverty rate dropped from 22% in 1990 to 16% in 2000. This change is significant considering the City of San Diego’s overall poverty rate increased from 13% to 15% during the same time frame.

Net Economic Impact of Enterprise Zones

When discussing net impacts at the state level, it is important to remember that the intent of the program was not originally to have a positive net economic impact, but rather to create

⁹ Kolko, Jed. “Do California’s Enterprise Zones Create Jobs?” Public Policy Institute of California. 2009. P. 15.

¹⁰ Nonprofit Management Solutions, Tax Technology Research LLC. 2006. P 18.

¹¹ Nonprofit Management Solutions, Tax Technology Research LLC. 2006

¹² City of San Diego. Economic Growth Services. www.sandiegoregionalez.org.

jobs and spur economic growth within blighted areas. The program has demonstrated success in this regard as described in the previous section.

A central question in evaluating the Enterprise Zone program is the degree to which improved economic conditions within Enterprise Zones comes at the expense of areas outside of Enterprise Zones. If growth in enterprise zones occurs at the cost of capital flight from other regions, then the short-term net economic effect of the program may not be substantial. While some research concluding that the Enterprise Zone program does little to attract businesses to California, the program may be more beneficial with regards to retention and expansion of local firms. The long-term economic effects of geographically focused economic development are less clear, and are dependent on the quality and implementation of the economic strategy used.

Fiscal Impact:

Fiscal Impact on the State Government of Proposed Changes in Regulations

According to the State Fiscal Year 2013-2014 budget proposed by Governor Brown:

“These regulatory reforms will primarily affect Corporation Tax revenue, but will also have an impact on Personal Income Tax revenue. The regulations, in total, are expected to increase General Fund revenue by \$10 million in 2012-13 and \$50 million in 2013-14.”

Fiscal Impact on the State Government of Enterprise Zones

The annual cost of Enterprise Zone tax credits and deductions has increased from \$675,000 in 1986 to \$465.9 million in 2008, for a total cost to the state of \$3.6 billion during the program’s existence.¹³

The increase in personal income tax payments attributable to growth within Enterprise Zones was \$250 million in 2002 and the increase in sales taxes resulting from growth in Enterprise Zones added an additional \$150 million in revenue in the same year, the most recent year such data was available¹⁴ (the total cost of Enterprise Zone tax credits and deductions in forgone revenues in 2002, for comparison, was approximately \$250 million).¹⁵

A similar question to that of net economic benefit is present concerning the net fiscal impact of the Enterprise Zone program at the state level. If the tax incentives are used primarily by companies that are already in California, the immediate fiscal cost of the program could be substantial as Governor Brown concluded. This conclusion however does not respect the long term fiscal impacts of retention and expansion of California businesses or geographically focused economic development.

If there is an immediate negative net fiscal impact, measuring it would identify the cost of investing in the economic development tool. In addition, monitoring the immediate net fiscal impact year to year would help to measure the success of reforms to the program. Tracking the taxpayer investment, in the form of immediate fiscal impact, should be

¹³ California Budget Project, “California’s Enterprise Zone Program: No Bang for the Buck”, 2011. P. 1

¹⁴ Bradshaw, Ted K., “How California’s Enterprise Zones Have Saved the State From Decline” University of California, Davis. 2006 P. 3

¹⁵ California Budget Project, “California’s Enterprise Zone Program: No Bang for the Buck”, 2011. P. 1

considered along with the return on investment in the form of economic development when assessing the long-term net fiscal impact.

Local Taxpayers

Enterprise Zones directly impact businesses within the designated zones primarily. Indirectly, the incentives offered are believed to spur investment and create more jobs.

List of Proponents of Enterprise Zones:

- California Association of Enterprise Zones
- California Chamber of Commerce
- National University System Institute for Policy Research
- California Association of Local Economic Development
- San Diego Institute for Policy Research
- Grover Norquist, Founder and President of Americans for Tax Reform

Proponent of Enterprise Zones Arguments:

- Compared to statewide averages, poverty levels in Enterprise Zones have dropped while household incomes and median rents have increased, since the program's inception in the 1980s.
- The increase in income and sales tax revenues paid to the state as a result of increased economic activity in Enterprise Zones offsets the cost of Enterprise Zone tax credits.
- Locally, the Enterprise Zone program has resulted in reduced poverty and increased employment in the poorest areas of San Diego and has spurred job growth and corporate investment throughout the San Diego Regional Enterprise Zone.

Opponents of Enterprise Zones:

- Public Policy Institute of California
- California Budget Project
- Howard Jarvis Taxpayers Association
- California Research Bureau

Opponent of Enterprise Zones Arguments:

- The program allows the state government to pick winners and losers, with non-Enterprise Zone areas losing jobs and paying a larger share of the tax burden.
- Enterprise Zone tax benefits are primarily claimed by large corporations rather than small businesses.
- Lack of new growth in manufacturing and low wage industries in Enterprise Zones indicates a failure of the program to benefit low income individuals.

Proponents of Proposed Regulations:

- Governor Brown

- American Society of Mechanical Engineers
- Communications Workers of America (San Diego Chapter)
- California Education Foundation
- UFCW Local 135

Proponent of Proposed Regulations Arguments:

- The use of retroactive vouchers does not provide the intended economic development benefits.
- The State cannot afford to be providing these tax breaks.

Opponents of Proposed Regulations:

- No outright opposition known. Several organizations have recommended changes to the proposed revisions.

Opponent of Proposed Regulations Arguments:

- No outright opposition known.

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