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California's Enterprise Zone Programs

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Senate Budget and Fiscal Review Subcommittee No. 4
  On State Administration and General Government

Hon. Richard Roth, Chair

Program Background

- ☑ ***Area Program Tax Benefits.*** About three decades ago, the Legislature began to use the state's tax code to benefit businesses and workers in areas that were deemed to be distressed. The intent was to mitigate the higher costs associated with doing business in those areas and to increase opportunities for certain people.

- ☑ ***Several Types of Areas.*** Tax incentive areas—Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Readjustment Areas (LAMBRAs)—were selected based largely on socioeconomic characteristics of the area and on the prevailing level of economic distress there. Legislation was enacted in 1984 for EZs, in 1998 for MEAs and the TTA, and in 1993 for LAMBRAs.

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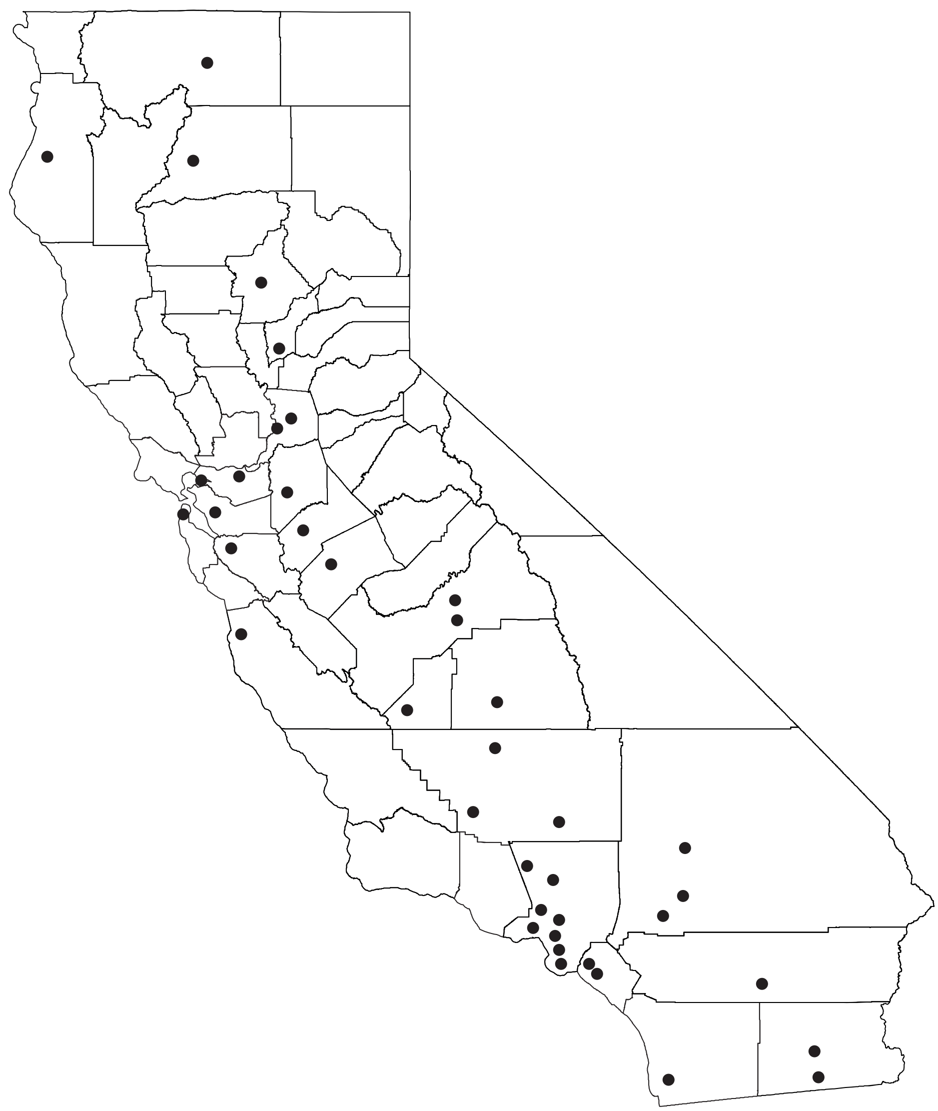
Enterprise Zones

As of June 2012



Source: Department of Housing and Community Development.

Does not display Tulare County targeted tax area, Brawley and Calexico manufacturing enhancement areas, or local military base recovery areas.

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Program Characteristics

☑ ***Various Types of Tax Benefits.*** Extensive tax benefits are or were available for each of the areas as shown in the table.

- Overall, the hiring credits are by far the most important—and expensive—such benefit.
- EZ tax benefits are available for having employees who reside in a Targeted Employment Area.
- An employee can be claimed for a hiring credit for up to five years.
- There are benefits other than those listed below, such as preferential treatment for state contracts.

	Hiring Credit	Longer NOL Carryforward Period[a]	Sales and Use Tax Credit	Accelerated Depreciation	Lender Interest Deduction
Enterprise Zones	X	X	X	X	X
Targeted Tax Areas	X	X	X	X	
Local Agency Military Base Recovery Areas	X	X	X	X	
Manufacturing Enhancement Zones	X				

[a] Recent legislation lengthened carryforward periods for all taxpayers.

NOL = net operating loss.

Program Usage

- ☑ ***Rapid Growth in Use of Hiring Credits.*** The number of employees claimed to be employed on tax returns grew from 24,190 to 140,833 between 1999 and 2010. In 2010, over 54,000 were claimed as "new" employees.
  - In 2010, the hiring and sales tax credits resulted in $698 million of reduced corporation and personal income tax revenues for the state. This amount has grown at an average annual rate of 18 percent since 2000—about six times faster than the rate of growth of the state budget over the same period.

- ☑ ***Substantial Benefits for Large Businesses.*** About 40 percent of the EZ hiring and sales tax credits goes to businesses that each had more than $1 billion in assets.

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How to Evaluate Program Effectiveness

☑ The EZ programs are used extensively. Use, however, is not the same thing as effectiveness. In assessing these programs, the Legislature will need to consider:

- Would more or fewer people have had jobs in the area if the state had used the money differently?
- Were some or many of the jobs for which credits are claimed offset by losses elsewhere?
- Did the programs reward decisions by firms and local governments that would have been made anyway?

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Assessments of the Program's Effect on Job Growth

- ☑ ***Generally Not Shown to Be Effective.*** Most rigorous research has found that EZs do not create a net increase in jobs or increase the rate of job creation.

- ☑ ***Gains in Some Areas Likely Accompanied by Losses in Others.*** Even if an EZ results in more job growth in a particular locality, it is likely that some of the jobs were shifted from other parts of the region or state.

- ☑ ***Statewide Job Impact Probably Limited.*** Given the shortage of evidence that EZs create jobs locally and the possibility that gains in one area of the state are offset elsewhere, the impact of the EZ program on statewide employment is likely limited.

Potential Reasons for Program's Limited Effectiveness

- ☑ ***Statewide Program May Not Address Diverse Local Issues.*** There are varied reasons why investment is limited in certain areas or why people without jobs and job openings are not well matched. Uniform sets of statewide tax credits likely are not the best way to address the real and diverse problems certain people or places experience.

- ☑ ***Retroactive Credits Are Poor Incentives.*** The ability of taxpayers to amend past returns and claim hiring credits provides more of a reward than an incentive. Therefore, retroactive hiring credits are unlikely to promote increased job creation. (We recommend that this practice be eliminated.)

- ☑ ***May Change Composition of Employment but Not Number Employed.*** Hiring credits may increase employment for qualified workers but result in a loss of other jobs not targeted by the credits.

- ☑ ***Some EZ Benefits Work at Cross Purposes.*** The EZ tax benefits related to equipment and machinery purchases may encourage businesses to shift away from more labor-intensive activities.

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Alternatives for Legislative Consideration

- ☑ ***Eliminating Enterprise Zone Programs.*** Because they are expensive and not shown to be effective, we recommend that the area programs be eliminated. Eliminating the programs could allow corporation tax rates statewide to be lowered by a part of a percentage point.

- ☑ ***Allowing Current Zones to Expire Over Time an Option.*** Options for eliminating the program include allowing currently designated zones to expire over a specified time line or preventing the extension of expiration dates for existing zones.

- ☑ ***Capping and Allocating Credits Also an Option.*** If the Legislature chooses not to eliminate the program, it could set a hard limit on the amount of tax benefits provided beginning in a future year. Businesses and/or zones could apply for these credits based on criteria specified in law. Alternatively, the credits could be awarded through a lottery.