Date of Hearing: August 30, 2020

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION
Autumn R. Burke, Chairwoman

SB 51 (Durazo) – As Amended August 30, 2020

2/3 vote. Fiscal committee.

SENATE VOTE: 36-1

SUBJECT: California Competes tax credit: refunds.

SUMMARY: Provides a refundable California Competes Tax Credit (CCTC) for a very narrow group of qualified taxpayers. Specifically, **this bill**:

1) Provides, for taxable years beginning on or after January 1, 2021, that a qualified taxpayer, to the extent the credit exceeds tax liability, may elect to be paid a refund for the CCTC from the Tax Relief and Refund Account. The amount refunded shall not exceed the amount of total taxes imposed by the state and paid by the qualified taxpayer during the taxable year.

2) Requires the qualified taxpayer to, upon request, provide necessary information, including certification from Governor's Office of Business and Economic Development (GO-Biz) that the taxpayer is a qualified taxpayer, as determined by and in the form and manner prescribed by the Franchise Tax Board (FTB), to be eligible for a refund of the credit.

3) Requires a qualified taxpayer that receives a refund to reinvest the refund into immobile capital equipment that supports infrastructure improvements, expansion, or developments for media production facilities in the state.

4) Provides that a qualified taxpayer may not reinvest refunds for the improvement of immobile capital equipment unless the improvements are made under a project labor agreement and using a skilled and trained workforce.

5) Defines a "qualified taxpayer" as a taxpayer that has created at least 5,000 prevailing wage, full-time or full-time equivalent jobs in the state each year for a period of 10 years.

6) Defines "full-time equivalent" as the workload of the full-time equivalent job that is comparable to one year of full-time work. One year of full-time work is measurable by the number of hours worked in one year, or by total wages paid in one year for the industry divided by the average annual salary.

7) Defines "immobile capital equipment" in the same manner as defined in the Internal Revenue Code (IRC) Section 1250(c).

8) Defines "project labor agreement" in the same manner as defined in the Public Contract Code Section 2500(b)(1).

9) Defines "skilled and trained workforce" in the same manner as defined in the Public Contract Code Section 2500 *et seq*.

10) Provides that the FTB may prescribe any regulations necessary or appropriate to carry out the purposes of this bill, including any regulations to prevent improper claims from being filed or improper payments from being made with respect to the refund of the credit. The FTB is also authorized to prescribe rules, guidance, and procedures, or other guidance to carry out the purposes of this bill.

EXISTING LAW establishes the CCTC 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: Pending

COMMENTS:

1) The author has provided the following statement in support of this bill:

> California must support proven and successful job creation tools. This means investing in full-time jobs with quality wages and benefits. The [CCTC] has been a meaningful tool to incentivize investment in good jobs while keeping companies accountable to their job commitment promises.
>
> SB 51 will allow the [CCTC] program to continue to catalyze critical investments in California that create thousands of high-wage jobs by providing additional flexibility for businesses participating in the CCTC program. The bill will allow CCTC awardees to apply part or all of that award to additional tax offsets (not exceeding total state tax liability) provided they make a long-term, high-wage job creation and economic investment commitment within our state.

2) Supporters state that this bill "will allow the California Competes credit awards to be utilized more broadly to offset other California taxes provided that the taxpayer makes a significant financial commitment to long term jobs by creating 5000 full-time equivalent (prevailing wage) jobs per year." Additionally, supporters argue that this bill "will make California Competes more workable and attractive to film and television companies that commit to investing in jobs over the next ten years. In addition, this bill provides a refund, under certain circumstances, and that refund must be reinvested in projects that work under a project labor agreement."

3) Committee Staff Comments:

   a) *Background*: In 2013, the Legislature enacted AB 93 (Committee on Budget), Chapter 69, Statutes of 2013, and SB 90 (Committee on Budget and Fiscal Review), Chapter 70, Statutes of 2013, measures which reformed California's economic development policies by eliminating enterprise zones and other geographically-targeted economic development areas, instead allowing three new tax benefits:

i) The New Employment Credit, where the FTB allocates credits for wages paid by taxpayers to qualified employees within former enterprise zones, and other areas that suffer from high levels of poverty and unemployment. The credit lasts from the 2014 taxable year until the 2019 taxable year. The Legislature extended the credit until 2026 [SB 855 (Committee on Budget and Fiscal Review), Chapter 52, Statutes of 2018].

ii) The CCTC Committee can award the CCTC up to an annually capped amount to taxpayers who apply. The Committee is comprised of the Treasurer, the Director of Finance, the Director of GO-Biz, one appointee of the Speaker of the Assembly, and one appointee from the Senate Committee on Rules. SB 855 also extended the Committee's authority to allocate $180 million in credits each year through the 2022-23 fiscal year.

iii) A state-only (3.9375%) sales and use tax exemption on purchases of manufacturing equipment made by taxpayers within specific North American Industrial Classification System codes, capped at $200 million annually per taxpayer, effective July 1, 2014, and ending July 1, 2022. In 2017, the Legislature expanded and extended this exemption, as part of an agreement to extend the Global Warming Solutions Act [AB 398 (E. Garcia), Chapter 135, Statutes of 2017].

The CCTC Committee is responsible for awarding the Competes Credit to businesses. The CCTC program provides tax benefits to select businesses in exchange for meeting contractual hiring and investment targets. Businesses may claim the tax credit only if they meet negotiated targets set forth in written agreements with GO-Biz. Up to $780 million in CCTC awards are available in total between fiscal year (FY) 2013-14 and 2017-18 ($30 million in year one, $150 million in year two, and $200 million per year in each of the following three years). For FYs 2018-19 through 2022-23, the annual awards are limited to $180 million. The amounts are adjusted depending on whether amounts had not been awarded in prior years or if amounts were recaptured.

To receive a credit, taxpayers must first apply during one of the application periods. There are usually three application periods per FY. According to the Legislative Analyst's Office, over 3,000 applications have been submitted between the start of the program and June 2017, with an average of about 300 applications per application period. Once the applications are submitted, GO-Biz evaluates the applications in two phases. In the first phase, the applications are scored and ranked based only on the amount of tax credit that the business has requested and the total dollar value of their proposed hiring and investments over five years. An applicant that requests a smaller tax credit, relative to the proposed amount of hiring and investment, receives a higher score. Only the highest scoring applicants move on to the second phase. However, firms that would expand in a high-unemployment or high-poverty city or county automatically move on to the second phase. In the second phase, GO-Biz reviews all of the other information that the applicants have provided. State law requires GO-Biz to base the amount of the tax credit award on several factors, such as the extent of unemployment or poverty in the area where the project would be located and other state or local incentives available to the applicant. In addition, GO-Biz may consider other factors in determining whether to award a tax credit. GO-Biz maintains a great deal of discretion when evaluating applications.

c) *What does this bill do*? This bill, in general, allows a qualified taxpayer to receive a refund from the Tax Relief and Refund Account to the extent the CCTC exceeds tax liability. However, the refund may not exceed the amount of total taxes imposed by the state and paid by the qualified taxpayer during the taxable year. Because the refund may not exceed the total tax paid by the qualified taxpayer, it is not a typical "refundable tax credit," but is a refund for taxes paid. This bill would require the taxpayer to reinvest the refund into immobile capital equipment that supports infrastructure improvements, expansion, or developments for media production facilities in the state.

d) *Who's getting the special treatment*? This bill defines a "qualified taxpayer" as a taxpayer that has created at least 5,000 prevailing wage, full-time or full-time equivalent jobs in the state each year for a period of 10 years. Clearly, a taxpayer that falls within this definition is likely to be a very large company. Looking through the CalCompetes Awardee list, Tesla's application has the highest net increase in full-time employees at 4,426 for a single agreement. Second on the list is FN Logistics with 3,039 full-time employees. However, a qualified taxpayer would also be required to reinvest the refund into immobile capital equipment that supports infrastructure for media production facilities in the state, which means that even some of the larger awardees may not be able to take advantage of the credit unless they are engaged in media production. Although there is no definition for "media production", some of the larger past awardees in this industry have included NBC Universal, Dreamworks Animation, Hulu, and Amazon. If media production companies are the ones that this bill is targeting, it may be more appropriate to modify the California Film Tax Credit instead of modifying the CCTC. Additionally, it is not clear why companies engaged in media production receive special treatment. As mentioned above, Tesla has promised to make a substantial investment in California as well as promised to hire over 4,000 employees, but will likely not benefit from this bill. If the goal, as stated by the author, is to "support proven and successful job creation tools," perhaps the refundability of the CCTC should be provided to all awardees that promise to hire a large number of employees.

e) *What taxes is this bill offsetting*? The refund available to a qualified taxpayer is limited to the amount of *total taxes imposed by the state and paid by the qualified taxpayer* during the taxable year. This bill does not define "total taxes"; as such, the taxes allowed to be offset by this bill is not clear. Obviously, "total taxes" likely includes those taxes other than the Personal Income Tax Law and the Corporation Tax Law, or a taxpayer would not be able to receive a refund. Hypothetically, these other taxes may include the sales taxes, but it is unclear if it would also include property taxes or payroll taxes since those may not be "imposed by the state." Assuming other taxes may be offset by this bill, it may be difficult for FTB and GO-Biz to ensure compliance without legislation allowing the sharing of taxpayer information between various departments. The author may wish to specify which taxes may be offset by the CCTC to prevent confusion and delay.

f) *Windfall*? The author's office states this bill focuses on businesses "willing to commit to and create a significant number of new prevailing wage jobs for the next 10 years." Unfortunately, this bill does not actually require a company to hire 50,000 new employees. The only requirement is that a company must have created, at some unknown point and time frame, 5,000 jobs per year for 10 years. Additionally, there is nothing preventing a company from firing those 5,000 employees and rehiring them the following year since there is no net-increase requirement for employment. In an industry like media production, where some jobs are for a short period of time, it is not uncommon for workers to be brought on and then let go over the course of several years. To ensure that the state receives a benefit for refunding a portion of the taxpayer's paid taxes, the author may wish to clarify that the hiring of 5,000 workers is prospective and cumulative.

Finally, the requirement that a refund be used to invest in immobile capital equipment may not actually provide the state with new economic activity. As an example, if NBC Universal qualified for a refundable CCTC as provided by this bill, it is likely that the immobile capital equipment requirement will be satisfied by NBC Universal's existing agreement to invest $36 million in the 2022 tax year and $96 million in the 2023 tax year[1]. As such, the state may be providing additional funds to companies without receiving any additional economic benefit.

g) *Lack of specificity*: This bill requires a qualified taxpayer to reinvest refunded amounts into immobile capital equipment that supports infrastructure improvements, expansion, or developments for media production facilities in the state. Unfortunately, the accompanying definitions provide little guidance with respect to what would qualify as "immobile capital equipment". The definition in this bill for "immobile capital equipment" basically states that a property qualifies so long as it can be depreciated[2]. Furthermore, the immobile capital has to support infrastructure improvements, expansion, or developments for media production facilities in the state, but no definition for "media production facilities" is provided. Without a clearer guidance, it becomes very difficult for the FTB or GO-Biz to effectuate the intent of this bill and also makes it very difficult for FTB and GO-Biz to ensure compliance.

h) *What is a "Tax Expenditure"*? Existing law provides various credits, deductions, exclusions, and exemptions for particular taxpayer groups. In the late 1960s, United States Treasury officials began arguing that these features of the tax law should be referred to as "expenditures," since they are generally enacted to accomplish some governmental purpose and there is a determinable cost associated with each of them (in the form of forgone revenues). This bill would expand an existing tax expenditure program by allowing the CCTC to be made refundable for a narrow class of taxpayers, and by allowing the CCTC to offset unknown state taxes.

i) *Committee's tax expenditure policy*: SB 1335 (Leno), Chapter 845, Statutes of 2014, added Revenue and Taxation Code (R&TC) Section 41, which recognized that the Legislature should apply the same level of review used for government spending programs to tax credits introduced on or after January 1, 2015. AB 263 (Burke), Chapter 743, Statutes of 2019, extended the requirements in R&TC Section 41 to all tax expenditure measures under the PIT Law, the CT Law, and the Sales and Use Tax Law introduced on or after January 1, 2020. A tax expenditure proposal must outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. This bill is subject to this Committee's tax expenditure policy because it expands the existing CCTC.

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[1] CCTC Allocation Agreement, NBC Universal,
[2] IRC Section 1250(c)

Unfortunately, this bill is not in compliance because it does not outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives.

In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote[3]. Sunsets are required because eliminating a tax expenditure generally requires a 2/3rd vote. It may be argued that the sunset of 2022-23 on the CCTC Committee's authority to allocate the CCTC functions as a sunset. However, the credit itself does not sunset until 2030. After discussing the language with Legislative Counsel, it is unclear if eliminating the refundability portion of this bill would trigger a 2/3rd vote, even if done after the 2022-23 FY ends. Although it is not clear, this bill should arguably contain a five-year sunset to allow the Legislature an opportunity to review the effectiveness of the credit.

REGISTERED SUPPORT / OPPOSITION:

Support

Entertainment Union Coalition

Opposition

None on file

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[3] An "appropriate sunset provision" shall mean five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" shall mean 10 years.