DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: January 12, 2012
POSITION: Oppose

BILL NUMBER: AB 643
AUTHOR: M. Davis
RELATED BILLS: AB 248

BILL SUMMARY: Income Taxes: Hiring Credits: Investment Credits

This bill would 1) change the existing Jobs Tax Credit to reduce the total credits available for all years from $400 million to $100 million, and 2) would authorize a new credit (the "California New Markets Tax Credit Program") in the amount of $300 million for taxable years beginning January 1, 2013, and before January 1, 2020, for investments in low-income communities. This credit would be limited to allow $50 million per year to be allocated.

FISCAL SUMMARY

At the time of this analysis the Franchise Tax Board (FTB) did not have fiscal or programmatic analysis available, although analysis is pending.

Finance estimates that should the full amount of the new market credits be allocated each year, this provision would result in annual General Fund losses of $50 million from 2012-13 through 2018-19.

According to FTB's most recent estimates of credit use, the reduction of the Jobs Tax Credit would increase General Fund revenues by $43 million in 2012-13, $60 million in 2013-14, $70 million in 2014-15, and $55 million in 2015-16. These would be gains versus the revenue estimates currently assumed in the Governor's Budget.

On net, based on the assumptions above, the state would lose $7 to $20 million in 2012-13. This would be followed by General Fund gains of $10 million in 2013-14, $20 million in 2014-15, and $5 million in 2015-16. In the long-run, this bill should be roughly revenue-neutral.

COMMENTS

The Department of Finance is opposed to this bill. While it may make sense to reduce the Jobs Tax Credit as it has been used slowly and may not be effective, this new tax credit does not necessarily fit in with the Governor's spending priorities. Further, it is not clear whether an additional 39 percent state tax credit, on top of an existing 39 percent federal tax credit, is an appropriate level for the credit. Finance has concerns that a tax credit equal to 78 percent of a qualifying investment may be excessive. While the federal tax credit must be claimed over seven years (5 percent in years 1-3 and 6 percent in years 1-4), there is no indication in this bill that the California credit must be claimed over the same period. Therefore, an investor could claim the entire 39 percent state tax credit in the first year. Of the nine other states that currently have a state New Markets Tax Credit, not one has a schedule that allows the entire state tax credit to be claimed in the first year.

Finance also notes that the federal New Markets Tax Credit expired at the end of 2011. It may be renewed sometime in 2012 retroactively, but if it is not renewed, the argument that this bill will lead to a significant leveraging of federal dollars would not be true. Even if the federal credit is restored, it is not clear that this state tax credit would be the most cost-effective use of state funds.

Analyst/Principal	Date	Program Budget Manager	Date
(0720) C. Angaretis		Mark Hill	

Department Deputy Director	Date

Governor's Office:	By:	Date:	Position Approved_______
			Position Disapproved

ANALYSIS

A. Programmatic Analysis

1) Reduction in Credits Related to the Jobs Tax Credit

Under current state law, Chapter 17, Statutes of 2009, Third Extraordinary Session (X3 SB15), allows a credit for taxable years beginning on or after January 1, 2009, for a qualified employer in the amount of $3,000 for each qualified full-time employee hired in the taxable year, determined on an annual full-time basis equivalent. The calculation of annual full-time basis would be the total number of hours worked for the taxpayer by the employee (not to exceed 2,000 hours per employee) divided by 2,000. A qualified employer is a taxpayer employing 20 or less employees. This credit is allocated by the FTB and has a cap of $400 million for all taxable years. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed after that date. Any credits not used in the taxable year may be carried forward up to eight taxable years.

This bill would change existing law to reduce the total credits available for this program from $400 million to $100 million.

Current credit use: As of December 31, 2011, the total Personal Income Tax and Business Entity returns claiming the Jobs tax credit was 12,914, and the amount of credits claimed was $76.1 million.

There has been a low amount of credit generated so far, relative to the amount of credit that could, conceptually, have been claimed. Finance believes that the primary reasons for this underutilization are that businesses are not aware of the credit, and the documentation requirements on eligible small business are too onerous to warrant seeking the credit.

2) California New Markets Tax Credit Program

Under current federal law, a “new markets tax credit” (NMTC) is allowed for a taxpayer’s qualified equity investments to acquire stock or a similar equity interest in a community development entity (CDE). The CDE’s primary mission must be serving, or providing investment capital for, low-income communities or low-income persons as certified by the Secretary of the Treasury. The taxpayer’s federal NMTC equals 39 percent of the qualified equity investment made in the CDE and is taken over seven years.

Current state law does not conform to the federal NMTC. A 20-percent state credit is allowed for each qualified investment in a California “community development financial institution” (CDFI). The qualified investment in the California CDFI must be at least $50,000, be for a minimum duration of five years, and may consist of either a deposit or loan that does not earn interest or an equity investment.

A California CDFI is defined as a private financial institution located in California and certified by the California Organized Investment Network that has community development as its primary mission and lends in urban, rural, or reservation-based communities in California.

This bill would, for taxable years beginning on or after January 1, 2013, and before January 1, 2020, authorize and create a California New Markets Tax Credit Program a tax credit equal to 39 percent of a qualified equity investment (QEI) for a taxpayer that holds a QEI on a credit allowance date. A credit allowance date is the date the investment is initially made.

This bill would cap the aggregate amount of credits for any calendar year at $50 million, plus any unused credits from the prior year, beginning in 2012, and up to and including the 2019 calendar year.

This provision defines a QEI as one in which an equity investment is made to a CDE that makes a qualifying investment in California low-income communities.

This bill defines a low-income community to mean a census tract where any of the following applies:

- The tract has a poverty rate of 20 percent.
- The tract is not located in a metropolitan area and the median family income does not exceed 80 percent of either the statewide median family income or metropolitan area median family income.
- The tract is located within a high-migration rural county, and the median family income does not exceed 85 percent of the statewide median family income, as specified.
- Where a community is in a location that is not tracted for population census tracts, the equivalent county divisions shall be used for determining poverty rates and median family income.
- Where a community has a census tract of under 2,000 people, that the community is to be treated as low-income if the tract is within a federal empowerment zone and is contiguous to one or more low-income communities.

This bill defines a qualified low-income community investment as the following:

- Any capital or equity investment in, or load to, a qualified low-income business, as specified.
- Any capital or equity investment in, or loan to, a real estate project in a low-income community.
- The purchase of a loan from another CDE that meets the requirements for a low-income community investment.
- Financial counseling and other services in support of business activities to businesses and residents of a low-income community.
- Any equity investment in, or loan to, a CDE.

The bill would require that the California Tax Credit Allocation Committee administer the program and authorizes the committee to establish and impose credit application fees to defray administration costs.

This bill would appropriate $150,000 from the Tax Credit Allocation Fee Account to the California Tax Credit Allocation Committee for implementation of new credit program. These funds will be available until January 1, 2020.

Discussion

According to the author’s office, the federal New Markets Tax Credit is a proven model of job creation and economic development: Nine other states have already created state matching programs and successfully leveraged over $30 billion for such local investments. On average, they have leveraged $13 in federal and private monies for every dollar of state revenue allocated to fund the New Markets Tax Credit. They are: Connecticut, Florida, Illinois, Kentucky, Louisiana, Mississippi, Missouri, Ohio, and Oklahoma. AB 643 proposes to divert $300 million from the existing state hiring tax credit to fund this new state program. This presents us with an opportunity to leverage, conservatively, up to $1.5 billion in federal and private matching funds for job creation by investing in small business and other federally qualified projects. While this bill would divert money from a pot of revenue currently allocated to small business, due to the opportunity to leverage federal and private matching funds it will actually increase aid to small business by increasing the pipeline of revenue that can be devoted to capital investment in such projects.

AUTHOR	AMENDMENT DATE	BILL NUMBER
M. Davis	January 12, 2012	AB 643

Provisions in AB 248 of the current session seeks a similar change as this bill by reducing the Jobs Tax Credit from $400 million to $250 million, but would create a new credit program which would allow physicians to deduct 25 percent of the value of medical services provided with no compensation under specified conditions. This bill would cap the total amount of the credit that can be allocated to $150 million over the four years

B. Fiscal Analysis

On net the state would lose $7 to $20 million in 2012-13. This would be followed by General Fund gains of $10 million in 2013-14, $20 million in 2014-15, and $5 million in 2015-16. In the long-run, this bill would be roughly revenue-neutral.

The maximum new market credits that may be allocated each year is $50 million. Should the full amount of these credits be allocated annually, this provision would result in annual General Fund losses of $50 million from 2012-13 through 2018-19.

According to FTB's most recent estimates of credit use, $97 million in credits would be used by the end of 2011-12, leaving only $3 million to be used in 2012-13 before the proposed new $100 million limit is reached. The reduction of the Jobs Tax Credit would increase General Fund revenues by $43 million in 2012-13, $60 million in 2013-14, $70 million in 2014-15, and $55 million in 2015-16, versus the revenue estimates currently assumed in the Governor's Budget.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2011-2012	FC	2012-2013	FC	2013-2014	Fund Code
1147/Pers Inc Tax	RV	No		-------------------- See Fiscal Analysis ---------------------					0001
1730/FTB	SO	No		-------------------- See Fiscal Analysis ---------------------					0001