

Economic Development – A Plan for Investment and Employment Incentives FACT SHEET

Proposal Summary:

The May Revision proposes to modernize the state's job creation and economic development incentives by reshaping existing programs to meet the need of the current economy. This program will include:

1. Hiring credit for businesses in specific areas with high unemployment and poverty rates.
2. Sales tax exemption on manufacturing and biotech research and development equipment.
3. Incentive fund to provide business tax credits in exchange for investments and employment expansion in California.

The proposal is revenue neutral and focuses on improving the performance of those dollars already spent. It will allow California to be more effective at stimulating economic growth and creating new jobs. The program will be designed to ensure that small businesses are able to easily obtain the manufacturing sales tax exemption, and will dedicate a portion of the hiring credit and the incentive fund solely to small businesses.

Background:

For over 25 years, California has created numerous Enterprise Zones, as well as other geographically-targeted economic development areas. Currently, there are 40 authorized Enterprise zones; this number is expected to continue to decline as authorizations expire and ongoing regulatory changes and audits are completed. These programs include many aspects, chief of which is a tax credit for new hires. In total, the tax benefits related to these programs currently cost the state about \$700 million per year. In its current form, it fails to encourage the creation of new jobs and instead rewards moving jobs from one place to another within the state, according to unbiased economic research. This, along with California's persistently high unemployment rate, argues for changes to encourage economic development and increase the number of jobs in California.

In 2009, the New Jobs Hiring Credit was created to support creation of new jobs through small businesses. To date approximately \$160 million has been claimed resulting in annual costs of approximately \$30 million to \$40 million annually. Based on the lifetime cap for this program, approximately \$240 million remains to be allocated.

Under current law, California requires a sales tax to be paid by manufacturers on the purchase of manufacturing equipment. When taxes are applied to purchases of manufacturing equipment, the final goods produced by that equipment are effectively taxed at more than the statutory rate. This leads to different effective tax rates for different types of goods (and higher tax rates for goods produced in California versus those same products produced outside of California). California is one of the few states that impose a sales tax on the purchase of manufacturing equipment. California firms have to pay more for the same manufacturing equipment as their competitors in other states, just because of the sales tax. The state share of sales tax for these purchases is approximately \$600 million annually.

Most interested parties want California's tax system to provide incentives that:

- Encourage employers to do business in the state's poorest areas.
- Encourage employers to hire individuals who are less employable than others, such as long-term unemployed, unemployed veterans, public assistance recipients, and severely low-income persons.
- Provide incentives to business to locate or expand within California.

Proposal Components:

The May Revision proposes to reshape and strengthen the state's economic development tax programs to bolster California's business environment and reintegrate people into the workforce by building upon the framework of existing targeted programs.

Hiring credit

The hiring credit will be refocused to specific areas with high unemployment and poverty rates both inside and outside existing zones. This credit will be available for the hiring of long-term unemployed workers, unemployed veterans, and people receiving public assistance. A portion of these funds will be targeted to small businesses.

Sales Tax Exemption

The existing sales tax exemption for businesses located in Enterprise Zones will be expanded to a statewide sales tax exemption on manufacturing or biotech research and development equipment purchases. A business will be allowed to exclude the first \$200 million equipment purchases from the state share of sales tax (4.25%) after approval by the Board of Equalization of a qualifying business exemption.

Investment Incentives

The California Competes Recruitment and Retention Fund will be created and will be administered by the Governor's Office of Business and Economic Development (GO-Biz). Businesses will have the opportunity to compete for available funds based on specified criteria including the number of jobs to be created or retained, wages that are at least two times the minimum wage, and a set job retention period. GO-Biz will negotiate agreements to provide businesses tax credits in exchange for investments and employment expansion in California. Approval of any proposed incentive will be made by an allocation committee that may recapture the incentive if the business fails to fulfill the terms and conditions of the contract. A portion of the incentive funds will be awarded solely to small business.