ReedSmith

Gov. Brown Proposes New Changes to California Enterprise Zone Program

Author: Marty Dakessian, Partner, Los Angeles
Author: Mike Shaikh, Associate, Los Angeles

Publication Date: May 24, 2011

California Gov, Jerry Brown recently issued his revised budget proposal. In his proposal, Gov. Brown once again targeted the Enterprise Zone program. However, rather than proposing to eliminate the program in its entirety, the governor has chosen to substantially restrict most of its benefits, including eliminating benefits retroactively.

The two most significant benefits of the Enterprise Zone program are the hiring credit and the sales and use tax credit (EZ Credits). The hiring credit is a credit available to taxpayers who hire certain qualified employees to work within an Enterprise Zone area. The sales and use tax credit is a credit for sales tax paid on purchases of machinery and machinery parts used to fabricate or manufacture a product that is used in an Enterprise Zone area. Each of these credits rewards taxpayers who invest in economically depressed areas. However, the governor's proposal would substantially limit these benefits.

Gov. Brown's revised proposal, if adopted, would change the Enterprise Zone program as follows:

- **Loss of EZ Credits generated prior to 2006.** Taxpayers who are entitled to EZ Credits are subject to limitations on the use of these credits based on their income. To the extent that the credits cannot be used, taxpayers can carry them forward. Gov. Brown's proposal would retroactively eliminate carryforwards of these credits generated prior to 2006.
- **Carryforward period reduced to five years for unused credits.** Gov. Brown's proposal would also retroactively set a five-year carryforward period from 2006 forward. Any credits generated but not used within five years would be eliminated. This includes credits generated by taxpayers who helped the most economically depressed areas of California during the recent economic downturn.
- **Credits must be filed for on the original return.** For various reasons, taxpayers may need to claim Enterprise Zone credits on an amended return. If the governor's proposal becomes law, taxpayers would only be able to claim the credit on an original return, thereby creating a procedural barrier for taxpayers.

- **Taxpayers must apply for hiring credit vouchers within 30 days of hiring.** To obtain the hiring credit, taxpayers currently have to obtain a voucher from a local Enterprise Zone administrator. The governor's proposal would require that such vouchers be obtained within 30 days of hiring an employee, creating another procedural hurdle to claiming these credits.
- **Reduction of hiring credit to $5,000 per employee.** Currently, the hiring credit is paid out over five years, in an amount equaling 50 percent of the employee's first-year salary in the first year and reduced by 10 percent of the employee's salary per year. This amount is capped at 150 percent of the statutory minimum wage. If the governor's proposal is passed, the maximum credit per employee would be reduced to $5,000.
- **Elimination of Eligibility Criteria.** The governor's proposal would repeal the numerous eligibility requirements (*e.g.*, low income earners, veterans, etc.) that favor hiring disadvantaged individuals by allowing tax credits to be claimed for hiring any individual.
- **Incremental increases in employment required.** Currently, taxpayers are eligible for the hiring credit for simply hiring a qualified employee. Going forward, taxpayers would be required to show that they incrementally increased company employment, further restricting the availability of the credit.

The governor's proposal would not only be bad for business in California, but it would also be unconstitutional. In terms of legality, the governor's second attempt at modifying the Enterprise Zone program is not substantially different from the first, as it severely restricts the program's benefits and strips taxpayers of vested benefits retroactively. For more information on the constitutionality of this proposal, please see our white paper.

About Reed Smith

Reed Smith is a global relationship law firm with more than 1,600 lawyers in 22 offices throughout the United States, Europe, Asia and the Middle East.

The information contained herein is intended to be a general guide only and not to be comprehensive, nor to provide legal advice. You should not rely on the information contained herein as if it were legal or other professional advice.

The business carried on from offices in the United States and Germany is carried on by Reed Smith LLP of Delaware, USA; from the other offices is carried on by Reed Smith LLP of England; but in Hong Kong, the business is carried on by Reed Smith Richards Butler. A list of all Partners and employed attorneys as well as their court admissions can be inspected at the website **http://www.reedsmith.com/**.