

## GO-Biz Releases California Competes Tax Credit Draft Proposed Regulations

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*On November 27, 2013, the Governor's Office of Business and Economic Development ("GO-Biz") released draft proposed regulations on the recently enacted California Competes Tax Credit, and has scheduled workshops throughout California for public comment.*

On July 11, 2013, Governor Brown signed Assembly Bill ("AB") 93 into law, which provides for various tax credits,<sup>1</sup> including the California Competes Credit ("CCC") – a credit against the income and franchise tax.<sup>2</sup>

For taxable years beginning on and after January 1, 2014 and before January 1, 2025, the CCC is allowed against the net tax in the amount allocated by the California Competes Tax Credit Committee (the "Committee").<sup>3</sup> Unused CCC may be carried over to reduce the net tax in the following taxable year and succeeding five taxable years,<sup>4</sup> but may not be used to reduce tax below the tentative minimum tax.<sup>5</sup> The CCC or carryover of the CCC earned by members of a combined reporting group may be assigned to an affiliated corporation that is a member of the same combined reporting group that is an eligible assignee.<sup>6</sup>

### Qualification for the CCC

A taxpayer must enter into a written agreement with GO-Biz which sets forth the amount of CCC to be allocated to the taxpayer. The agreement is subject to Committee approval.<sup>7</sup> The amount of CCC to be allocated to a taxpayer must be based on the following factors:<sup>8</sup>

<sup>1</sup> AB 93 provides for a sales and use tax exemption for purchases of manufacturing-related equipment, a targeted income and franchise tax hiring credit, and the California Competes Credit.

<sup>2</sup> Sections 17059.2 and 23689. All statutory references are to the California Revenue and Taxation Code unless otherwise stated.

<sup>3</sup> Sections 17059.2(a) and 23689(a). The Committee consists of the Treasurer, the Director of Finance, the Director of GO-Biz, and one appointee each from the Senate and the Assembly. Section 18410.2(a).

<sup>4</sup> Sections 17059.2(e) and 23689(e).

<sup>5</sup> See Franchise Tax Board ("FTB") FAQ 2 and 3. FTB FAQs can be found at the following link: [https://www.ftb.ca.gov/businesses/Economic\\_Development\\_Incentives/California\\_Competes\\_Credit.shtml](https://www.ftb.ca.gov/businesses/Economic_Development_Incentives/California_Competes_Credit.shtml)

<sup>6</sup> FTB FAQ 5.

<sup>7</sup> The Committee must approve or reject any written agreement for an allocation of CCC by resolution at a duly-noticed public meeting held in accordance with the Bagley-Keene Open Meeting Act (Sections 11120, et. seq. of the Government Code), after receipt of the fully executed written agreement between the taxpayer and Go-Biz. Section 18410.2(b)(1).

- The number of jobs the taxpayer will create or retain in California.
- The compensation paid or proposed to be paid by the taxpayer to its employees, including wages and fringe benefits.
- The amount of investment in California by the taxpayer.
- The extent of unemployment or poverty in the area according to the U.S. Census in which the taxpayer's project or business is located.
- The incentives available to the taxpayer in California, including from state and local governments and other entities.
- The incentives available to the taxpayer in other states.
- The duration of the proposed project and the duration the taxpayer commits to remain in California.
- The overall economic impact in California of the taxpayer's proposed project or business.
- The strategic importance of the taxpayer's project or business to California, the region, or locality.
- The opportunity for future growth and expansion of the taxpayer's business in California.
- The extent to which the anticipated benefits to California exceed the projected benefit to the taxpayer from the Credit.

The written agreement between the taxpayer and GO-Biz shall include:<sup>9</sup>

- Terms and conditions for minimum compensation levels and job retention periods.
- Provisions indicating whether the CCC is to be allocated in full upon approval, or in increments based on mutually agreed upon milestones achieved by the taxpayer.
- Provisions that allow the Committee to recapture the CCC (in whole, or in part) if the taxpayer fails to fulfill the terms and conditions of the written agreement.

## Recapture

If the taxpayer fails to fulfill the terms and conditions of the agreement, GO-Biz may recommend recapture of the CCC to the Committee.<sup>10</sup>

The FTB must review the books and records of all taxpayers who have been allocated the CCC to ensure compliance with the terms and conditions of the written agreement with GO-Biz.<sup>11</sup> This review is separate from the FTB's normal audit of an income tax return, and does not preclude the FTB from auditing any other item on the taxpayer's income tax return.<sup>12</sup>

The FTB must also notify and provide information to GO-Biz of a possible breach of the written agreement, and whether a taxpayer is a "small taxpayer," notwithstanding Section 19542.<sup>13</sup> The Committee, not the

<sup>8</sup> Sections 17059.2(a)(2) and 23689(a)(2).

<sup>9</sup> Sections 17059.2(a)(3) and 23689(a)(3).

<sup>10</sup> The Committee is required to approve or reject any recommendation to recapture CCC (in whole, or in part) by resolution at a duly noticed public meeting held in accordance with the Bagley-Keene Open Meeting Act (Sections 11120, et. seq. of the Government Code), after receipt of the recommendation from Go-Biz pursuant to the terms of the fully executed written agreement. Section 18410.2(b)(2).

<sup>11</sup> Sections 17059.2(d) and 23689(d). The FTB has discretion to review compliance with the terms and conditions of a written agreement between GO-Biz and a taxpayer that is a "small business" as defined by Section 17053.73(b)(14)(A). That section defines a "small business" as "a trade or business that has aggregate gross receipts, less returns and allowances reportable to this state, of less than two million dollars (\$2,000,000) during the previous taxable year." For these purposes, the term "gross receipts" includes receipts attributable to both business and nonbusiness income. Section 17053.73(b)(14)(B)(i).

<sup>12</sup> FTB FAQ 7.

<sup>13</sup> Section 19542 generally prohibits the FTB from disclosing taxpayer information.

FTB, is responsible for determining whether any CCC must be recaptured, and the amount of any such recapture.<sup>14</sup>

Any recapture of CCC is treated as a mathematical error appearing on a return, and any amount of tax resulting from that recapture shall be assessed by the FTB in the same manner as provided in Section 19051.<sup>15</sup> The amount of tax resulting from recapture of the CCC is added to the tax otherwise due by the taxpayer for the taxable year in which the Committee's recapture determination occurred.<sup>16</sup>

### CCC Allocation Limitations

The aggregate amount of CCC that may be allocated in any fiscal year<sup>17</sup> is as follows:<sup>18</sup>

- 2013-2014 fiscal year---\$30 million.
- 2014-2015 fiscal year---\$150 million.
- For each fiscal year thereafter, until fiscal year 2018-2019---\$200 million.
- No maximum allocation has been set for fiscal years after 2018-2019.

The above amounts will be increased by unallocated amounts of CCC (if any) from the preceding fiscal year, and the amount of any previously allocated CCC that has been recaptured.<sup>19</sup>

These amounts will be decreased by the amount estimated by the Director of Finance, in consultation with the FTB and the State Board of Equalization, to be necessary to limit the aggregation of the new sales and use tax manufacturing exemption, the new income tax hiring credit, and the CCC to \$750 million for either the current fiscal year, or any of the three succeeding fiscal years.<sup>20</sup>

Each fiscal year, 25 percent of the aggregate amount of the CCC permitted to be allocated is reserved for small businesses,<sup>21</sup> and no more than 20 percent may be allocated to any one taxpayer.

### Duties of GO-Biz<sup>22</sup>

- Give priority to a taxpayer whose project or business is located or proposed to be located in an area of high unemployment or poverty.
- Negotiate with a taxpayer the terms and conditions of a proposed written agreement setting forth the CCC to be allocated to said taxpayer.
- Provide the negotiated written agreement to the Committee for its approval.
- Inform the FTB of the terms and conditions of the written agreement, upon approval by the Committee.
- Inform the FTB of any recapture of a previously allocated CCC, upon approval of the recapture by the Committee.



<sup>14</sup> FTB FAQ 8.

<sup>15</sup> Sections 17059.2(f) and 23689(f).

<sup>16</sup> Sections 17059.2(f) and 23689(f).

<sup>17</sup> California's fiscal year begins on July 1.

<sup>18</sup> Sections 17059.2(g)(1) and 23689(g)(1).

<sup>19</sup> Sections 17059.2(g)(1)(B) and (C); 23689(g)(1)(B) and (C).

<sup>20</sup> Sections 17059.2(g)(1)(D) and 23689(g)(1)(D).

<sup>21</sup> Sections 17059.2(g)(2) and 23689(g)(2).

<sup>22</sup> Sections 17059.2(c) and 23689(c).

- Post on its website: (a) the name of each taxpayer which is allocated a CCC; (b) the estimated amount of the investment by each taxpayer; (c) the estimated number of jobs created or retained; (d) the amount of CCC allocated to a taxpayer; and (e) the amount of CCC recaptured from a taxpayer, if applicable.

GO-Biz is authorized to prescribe rules and regulations to carry out the purposes of the CCC, and these may be adopted by an emergency regulation in accordance with Section 11340, et. seq. of the Government Code.<sup>23</sup> A written agreement between GO-Biz and a taxpayer with respect to the CCC must comply with existing law on the date the agreement is executed.<sup>24</sup>

### Intergovernmental Reporting

Upon the effective date, the Department of Finance shall estimate the total dollar amount of the CCC that will be claimed for each fiscal year from 2013-2014 through 2024-2025.<sup>25</sup>

By March 1 of each year, the FTB shall provide to the Joint Legislative Budget Committee a report of the total dollar amount of the CCC claimed during the relevant fiscal year. The report shall compare the total dollar amount of CCC claimed with those amounts estimated by the Department of Finance.<sup>26</sup> If the total dollar amount of the CCC claimed for the fiscal year is less than the estimate for that fiscal year, the report shall identify options for increasing annual claims of the CCC so as to meet the estimated amounts.<sup>27</sup>


### GO-Biz Draft Proposed Regulations

On November 27, 2013, GO-Biz released draft proposed regulations on the CCC. Applicants are to set forth the amount of CCC requested in the application, subject to the statutory limitations (maximum of 20 percent of the aggregate CCC permitted for any one taxpayer for each fiscal year).<sup>28</sup>

The application period will be announced annually on the GO-Biz website prior to each new fiscal year, except for the fiscal year 2013-14 application period, which will be announced after the proposed regulations are approved by the Office of Administrative Law.<sup>29</sup>

The application announcement will state the application period, the deadlines to submit applications, the date hearings will be held to approve or reject the CCC allocation agreements, and the CCC available during each application period.<sup>30</sup>

GO-Biz may announce multiple application periods within a fiscal year to assure all of the available credit for a fiscal year is not exhausted in the beginning of the fiscal year. If multiple application periods are announced for a single fiscal year, the maximum credit permitted for the fiscal year is divided by the number of application periods.<sup>31</sup>

 <sup>23</sup> Sections 17059.2(h) and 23689(h).

<sup>24</sup> Sections 17059.2(h)(i) and 23689(h)(i).

<sup>25</sup> Sections 17059.2(j)(1) and 23689(j)(1).

<sup>26</sup> Sections 17059.2(j)(1) and 23689(j)(1).

<sup>27</sup> Sections 17059.2(j)(2) and 23689(j)(2).

<sup>28</sup> Draft Proposed Regulation section 8010.

<sup>29</sup> Draft Proposed Regulation section 8020(a).

<sup>30</sup> Draft Proposed Regulation section 8020(b).

<sup>31</sup> Draft Proposed Regulation section 8020(d).

If an applicant is not awarded any CCC allocation in the then-current application period, the applicant will be considered in the next application period of that fiscal year.<sup>32</sup>

Upon commencement of the new fiscal year, any application submitted and not awarded CCC during the prior fiscal year will expire and applicants will need to submit a new application for consideration during the next application period of the then-current fiscal year.<sup>33</sup>

The application process is to be conducted online via the GO-Biz website. The application will ask for information listed in section 8030(a)(1)-(50) of the draft proposed regulations, which includes:

- The amount of the CCC requested.
- The timeframe for when the applicant would like the CCC to be provided (e.g., allocation of allowed CCC to various tax years).
- If a consultant has been used, and whether the consultant's compensation is contingent on the amount of CCC awarded.
- Number of employees (in California, by state, and worldwide), location of headquarters, date business established (in California and worldwide).
- Description of proposed project and impact of project on California jobs.
- Whether permits are required for the project, and if so, whether those permits are approved, pending, or yet to be applied for.
- Amount of project financing and costs.
- Whether applicant is considering relocating to another state.
- Other incentives the applicant expects to utilize (e.g., employment tax credit, sales tax exemption, local incentives).
- Disclosure of material litigation.
- If applicant is delinquent on any California state tax liabilities.

GO-Biz will implement a two-phase application review process.<sup>34</sup> Phase one includes an automated rate of return calculation based on an applicant's proposed in-state investment compared to the amount of CCC requested. Applicants providing the highest rate of return will be invited to phase two. Notwithstanding the above, GO-Biz may invite applicants to phase two if the owner, President, CEO, CFO, or other equivalent person of the applicant certifies in writing to GO-Biz that applicant is at risk of relocating out-of-state absent CCC consideration.

In phase two, GO-Biz will evaluate applicants based on multiple factors set forth in section 8030(e)(1)-(9) of the draft proposed regulations, including:

- The extent of unemployment in area of proposed project.
- Whether incentives are available to applicant in other states.
- Economic impact of applicant's business in the state.
- The strategic importance of the applicant's project in the state, region, or locality.

<sup>32</sup> Draft Proposed Regulation section 8030(l).

<sup>33</sup> Draft Proposed Regulation section 8030(m).

<sup>34</sup> Draft Proposed Regulation section 8030(c).

- The number of existing employees to be hired or retained.
- The opportunity for future growth or expansion.
- Employee fringe benefits.

If readiness and site control are factors in the evaluation as to whether CCC will be awarded, site control may be evidenced by fee title, executed leases, executed development agreements, or valid purchase and sale agreements or contingent purchase and sale agreements, or leases or the equivalent.<sup>35</sup>

Negotiation of CCC during phase two will be based on various factors,<sup>36</sup> including:

- Number of in-state jobs created and compensation levels.
- The amount of in-state investment.
- Unemployment or poverty in the project area.
- Incentives available to the applicant in other states.
- Duration of the proposed project, and duration of applicant's commitment to remaining in the state.
- Overall economic impact of the project or applicant's in-state business.
- Strategic importance of the project or applicant's business to the state or locality.
- Opportunity for future growth and expansion in the state.
- Extent to which anticipated benefits exceed CCC.

Section 8040(a)-(e) of the draft proposed regulations describes the content of a CCC allocation agreement, including CCC allocation amounts, taxable years CCC shall be allowed, CCC allocations based on achieved milestones, and recapture provisions.

Section 8050(a)-(e) of the draft proposed regulations describes the process of committee approval of any CCC agreement negotiated by GO-Biz and the applicant.

Section 8060(a)(1)-(5) of the draft proposed regulations states what GO-Biz must post on its website regarding any CCC awarded (name, amount of investment in state, amount of CCC allocated, and any CCC recapture).

Section 8070(a)-(f) of the draft proposed regulations lists the duties of the FTB. The FTB must review taxpayer compliance with the agreement and notify GO-Biz of any material non-compliance. If GO-Biz (with Committee approval) requires recapture of previously allocated CCC as a result of non-compliance with the agreement, it shall notify the FTB of the terms and amount of the recapture.

## Workshops

GO-Biz has scheduled public workshops to discuss the draft proposed regulations. The workshops are scheduled for Sacramento on December 5th, Fresno on December 9th, Hayward on December 11th, San Diego on December 17th, San Bernardino on December 18th, Los Angeles on December 19th, and a webinar on December 20th. A copy of the draft proposed regulations and the above workshop schedule has been posted to the GO-Biz website which can be accessed at the following link:

<http://business.ca.gov/Programs/CaliforniaCompetes.aspx>



<sup>35</sup> Draft Proposed Regulation section 8030(f).

<sup>36</sup> Draft Proposed Regulation section 8030(i).

*This material is not intended to constitute a complete analysis of all tax considerations. Internal Revenue Service regulations generally provide that, for the purpose of avoiding United States federal tax penalties, a taxpayer may rely only on formal written opinions meeting specific regulatory requirements. This material does not meet those requirements. Accordingly, this material was not intended or written to be used, and a taxpayer cannot use it, for the purpose of avoiding United States federal or other tax penalties or of promoting, marketing or recommending to another party any tax-related matters.*

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