FROM: Los Angeles County Economic Development Corporation

TO: Kish Rajan, Executive Director, Governor's Office of Business and Economic Development (GO-Biz)

DATE: December 17, 2013

RE: Comments on California Competes Tax Credit

M E M O R A N D U M

The California Competes Tax Credit is a program that has long been needed in the State of California. The program, which awards a credit to businesses against their income and franchise tax, provides another important tool for California to compete against many other states (and nations) that currently offer lucrative incentive packages for companies in growing, highly-sought after sectors. Location in a global economy is by choice, and we have seen over the years many companies from some of our state's most prized industries, such as biotech, entertainment and aerospace, lured away to other places by eye-popping incentive packages. We need a program that helps us fight back, so that we can keep and attract more of these high-value businesses and jobs here. The California Competes Tax Credit is a good first step toward providing that ammunition.

Even so, the initial proposed draft regulations, released by GO-Biz (dated: November 27, 2013), guiding the implementation of the California Competes Tax Credit program, are unclear as to the priority that will be paid to a number of critically important and very consequential economic considerations that would maximize the rate of return of the credit. These economic considerations ought to help frame and guide GO-Biz's evaluation of the express "factors," as described in Sections 17059.2(a)(2) and 23689(a)(2) of the California Revenue and Taxation Code, that will be used to award credits to deserving businesses within California's different regional economies, which are the key to the state's overall economy, as well as to help clarify and "clean-up" certain ambiguous terms and definitions express to Sections 17059.2(g)(2) and 23689(g)(2) of the same code.

Accordingly, on behalf of the Los Angeles County Economic Development Corporation (LAEDC), an organization dedicated to promoting job growth, economic expansion, and preserving the overall global competitiveness of Los Angeles County and the State of California, we offer the following recommendations and comments on the proposed California Competes Tax Credit regulations to ensure the program maximizes the co-equal goals of directly creating or retaining jobs in highly-sought after industries and amplifying the significant multiplier effects that come from growing jobs in these important sectors:

I. Sections 17059.2(a)(2) and 23689(a)(2) of the Revenue and Taxation Code read, in part: "**The amount of credit allocated to a taxpayer for a taxable year pursuant to this section shall be as set forth in a written agreement between GO-Biz and the taxpayer and shall be based on the following factors:…"**

A. "The number of jobs the taxpayer will create or retain in this state."

- <u>Recommendation One</u>: Shall include "direct," "indirect" and "induced" jobs
- <u>Rationale</u>: High "multiplier effect" sectors should receive preference and priority.
- <u>Recommendation Two</u>: Shall prioritize businesses that hire existing in-state residents over businesses/sectors that will bring workers in from out of state.

- Rationale: Goes without saying that we need to create more jobs for California residents.

B. "The compensation paid or proposed to be paid…."

- Recommendation: Shall pay an average annual wage equal to or higher than the state average annual wage, or, if pay is below the state average annual wage, demonstrate the existence of career ladders that can reasonably be expected to lead to wages equal to or above the state annual wage.
- Rationale: The type of job matters; we want to incentivize the creation of high-value, high-wage jobs with built-in career ladders. For example, we know that the average annual wages (2011) in California for entertainment, aerospace, IT, biomedical, trade and analytical instruments are $94,378; $96,407; $151,645; $91,311; $70,052 and $103,758, respectively.

C. "The amount of investment in this state by the taxpayer."

- Recommendation One: Shall include important factors such as: investment in workforce and job-training in-state; significant dependence on design and/or supply chain sourcing in-state; investment in/purchaser of commercial durable goods (e.g., equipment) in-state; investment in real estate/building development and/or renovation in-state; Brownfield development; etc.
- Rationale: We want to incentivize firms that have deep local/regional/state ties (e.g., fixed assets, supply chain reliance, etc.) because the ancillary and secondary investment impacts will be greater.
- Recommendation Two: Shall prioritize businesses from **traded industry sectors,** which both are at the highest risk of leaving the state because they are not dependent on the local consumer base and pay an average annual wage that is 70 percent higher than the average wage paid in locally-serving industry clusters (e.g., retail, fast food, etc.).
- Rationale: Traded sectors – like biotechnology, IT, aerospace and entertainment – bring more ancillary investment and capital back into the state, and at the same time raise the average wage and output levels of locally/population-serving sectors. And as stated above, traded sectors are, by definition, not wholly dependent on the local population/consumer base and are thus at greater risk of leaving.

D. "The overall impact in this state of the taxpayer's….business"

- Recommendation: Shall include "direct," "indirect" and "induced" impacts.
- Rationale: As stated above, high "multiplier effect" sectors (e.g., IT, biomedical, aerospace, analytical instruments, entertainment, medical devices, etc.) should receive priority.

E. "The strategic importance of the taxpayer's…business to the state, region, or locality."

- Recommendation One: Shall prioritize businesses from industry sectors with high state and regional concentrations of employment (as measured by their "location quotients" (LQ)) compared to the nation; or, that are otherwise identified as a target industry in a local or regional economic development strategy, or an economic development element to a General Plan.
  - Shall give preference to businesses from industry sectors with a state LQ above 1.0; and (not "or")
  - Shall give preference to businesses from industry sectors with a regional/county LQ above 1.5.

- Rationale: We want to incentivize businesses and jobs from regional clusters that have high employment concentrations and regional specialization. Attracting, growing or retaining businesses that are part of existing "thick labor markets" creates marked multiplier and anchoring effects, which make them less likely to leave California. For example, industry clusters such as aerospace and analytical instruments have high LQs – state: aerospace – 1.3 and analytical instruments –1.9; regional (L.A. County): aerospace – 2.5 and analytical instruments – 2.1.
- Recommendation Two: Shall give preference to applications where multiple businesses (large and small) come together and submit applications.
- Rationale: Programmatic incentives that support supply chains have more of an accretive effect on the California, regional and local economies.
- Recommendation Three: Shall enable cities to package deals for California Competes Tax Credit Committee approval.
- Rationale: It's important to incentivize and leverage locally-driven attraction/retention efforts that are driven by individual cities.
- OTHER potential recommendations (under "E"):
  - Shall give preference to businesses from export-oriented sectors
  - Shall give preference to businesses with a high concentration of STEM-based jobs

II. Sections 17059.2(g)(2) and 23689(g)(2) read, in part: **"…Each fiscal year, 25 percent of the aggregate amount of the credit that may be allocated shall be reserved for 'small businesses'..."**

- Recommendation**:** Make it easier for small businesses to apply by offering one-on-one assistance with the application process, as well as opportunities to be reimbursed for costs incurred during the application process.
- Rationale: It will be cost prohibitive for many small businesses to take advantage of all the reporting, auditing and other requirements under this law.
- Recommendation**:** Offer clean-up legislation to redefine "small business," which is currently defined as business that has aggregate gross receipts, less returns and allowances reportable to this state, of less than $2,000,000 during the previous taxable year.
- Rationale**:** The law requires that 25 percent of the credit be awarded to "small businesses," which may never get spent under this prescriptive and very limited definition of small business.
- Recommendation**:** Clarify the term "aggregate" amount.

In conclusion, the LAEDC commends GO-Biz's leadership in developing and promulgating the proposed rules guiding the implementation of the California Competes Tax Credit to help retain and attract businesses – and the jobs they create – in California. We very much appreciate the opportunity to provide the abovementioned recommendations, and we look forward to working with your office during the upcoming "Los Angeles County California Competes Tax Credit Workshop" and beyond to improve the credit program and maximize its impacts on the tapestry of regional economies, such as Los Angeles County, that make-up and are essential to the overall success of the California state economy.

Bill Allen
LAEDC, president & CEO