

SUBJECT: Tax incentives offered to enterprise and defense readjustment projects

COMMITTEE: Economic Development — committee substitute recommended

VOTE: 6 ayes — Solis, Keffer, Clark, Homer, McClendon, Yarbrough

0 nays

3 absent — Deshotel, Luna, Seaman

WITNESSES: For — Ed Davis, City of San Antonio; *Registered but did not testify*:
Spencer Chambers, Texas Association of Business and Chambers of
Commerce

Against — None

On — *Registered but did not testify*: Craig Pinkley, Texas Department of
Economic Development

BACKGROUND: **Enterprise zones and projects.** The Texas Enterprise Zone Act (Government Code, chapter 2303) authorizes the creation of enterprise zones in economically distressed areas to encourage private investment in those areas. To be eligible for the designation, an area must meet specific unemployment rate, income level, and population or job-loss rate criteria. Cities and counties may nominate up to three areas for designation by the Texas Department of Economic Development (TDED).

Businesses are offered tax refunds and abatements as incentives to remain or locate within an enterprise zone. Businesses that locate in an enterprise zone and commit to hiring at least 25 percent of new employees from among zone residents or economically disadvantaged people are eligible for a one-time state sales-tax refund of up to \$5,000 and for local government incentives, including up to a 5-percent reduction in electric utility rates and some sales tax refunds.

An enterprise zone may nominate a business that is eligible for these tax refunds and abatements to TDED for designation as an enterprise project.

Enterprise projects are authorized to receive a rebate on their state sales tax of \$2,000 per job created for five years, up to a maximum of \$250,000 per year, as well as a franchise tax reduction. The municipality also must offer other incentives, such as tax abatements, fee waivers, and expedited permitting.

Defense economic readjustment zones and projects. Government Code, chapter 2310 authorizes the creation of defense economic readjustment zones in adversely affected defense-dependent communities to encourage private investment in those areas. Cities and counties may nominate up to three areas for designation by TDED.

A defense economic readjustment zone may nominate a business to TDED for designation as an defense readjustment project. To be eligible as such a project, a business must locate in an enterprise zone and commit to hiring at least 25 percent of its new employees from among zone residents, economically disadvantaged people, or displaced defense workers. Defense readjustment projects are authorized to receive a rebate on their state sales tax of \$2,500 per job created for five years, up to a maximum of \$250,000 per year, as well as a franchise tax reduction. The municipality must offer other incentives, such as tax abatements, fee waivers, and expedited permitting.

DIGEST: CSHB 2686 would change various provisions relating to tax credits received by enterprise projects and defense readjustment projects.

The bill would authorize TDED to monitor a qualified business, enterprise project, or defense readjustment project to determine whether the business or project had followed through on its commitments. If the business or project substantially had failed to follow through or had refused to cooperate with TDED to make that determination, the department could determine that the business or project was not eligible for a tax refund or credit.

The bill would entitle enterprise projects and defense readjustment projects to a franchise tax credit, rather than a reduction, for job creation and capital investments. It would add tangible personal property purchased and consumed in the normal course of business in the enterprise zone or defense readjustment zone and taxable services to the list of equipment and services

on which an project could receive a tax refund. A corporation could claim the entire franchise tax credit earned during an accounting period against taxes imposed for the corresponding reporting period.

CSHB 2686 would reduce from 625 to 250 the number of new permanent jobs or retained jobs that an enterprise project could claim for a tax refund. It would increase from \$2,000 to \$5,000 the amount of the tax refund a business could receive per employee.

The bill would decrease from \$10,000 to \$4,000 the maximum tax refund that an employer could receive for wages paid to an employee receiving financial assistance, but it would increase the percent of the wages that an employer could receive in refunds from 20 percent to 40 percent. An employer could claim a tax refund for an employee only if that employee performed at least 50 percent of the employee's services in an enterprise zone, federal empowerment zone, or federal enterprise community.

This bill would take effect September 1, 2001, and would apply only to an enterprise project or defense readjustment project designated by TDED on or after that date. The provisions allowing an project to claim the entire credit earned in an accounting period against taxes imposed during the corresponding reporting period would not take effect until January 1, 2002, and would apply to a report due on or after that date.

**SUPPORTERS
SAY:**

CSHB 2686 would increase the incentives for designated enterprise and defense readjustment projects to create new jobs and investments in those zones, while ensuring that only a project that followed through on the job creation and investment commitments it promised could receive those credits.

Because the state has no authority to monitor whether projects provide the jobs and investment promised in their applications for designation and to withhold incentives from those that do not, applicants can promise more than they can deliver to win the competitive application process. The state loses in this process, because applications that might have provided more jobs and investment went unselected. By allowing the state to withhold incentives if these promises were not met, CSHB 2686 would help ensure that businesses would create the jobs and investment promised in their applications.

CSHB 2686 simultaneously would reduce the number of new jobs that an employer could claim for a tax refund and would increase the amount of the refund available for each employee, thus leaving unchanged the total dollar amount of refunds available to a project. By providing a higher amount of refunds per employee, the bill would allow employers to hire lower-skilled employees who need more training, thus pulling more people out of welfare. The bill would not reduce the incentive on businesses to create a high number of jobs, because the cap would remain higher than the number of jobs created by most of these businesses.

The bill also would replace the franchise tax refunds offered to these projects with franchise tax credits. Credits are a more attractive incentive to businesses, as they are worth more per dollar.

OPPONENTS
SAY:

Although expanding incentives for job creation in the state would be beneficial, CSHB 2686 would cost too much to implement. The bill's fiscal note estimates a net cost of \$1.4 million in fiscal 2002-03, with a steadily increasing cost thereafter.

NOTES:

The author intends to offer a floor amendment to strike the bill's provisions relating to tax refunds for an employer who employed people receiving financial assistance, as those provisions are partly responsible for the fiscal note.

The committee substitute removed provisions from the filed version that would have entitled an enterprise project to a franchise tax credit for research and development activities. It also removed provisions authorizing an enterprise project or defense readjustment project to multiply by two the amount of research expenses and payment for calculating the tax credit, and it added the provision limiting the bill's effect to enterprise projects and defense readjustment projects designated on or after September 1, 2001.