Subject Matter of Proposed Regulations: California Competes Tax Credit (CCTC) Program

As required by Section 11346.9 of the Government Code, the Governor’s Office of Business and Economic Development (GO-Biz) sets forth below the reasons for the adoption of and amendments to Sections 8000 – 8040 of Title 10, Chapter 13, Article 1.

UPDATE OF INITIAL STATEMENT OF REASONS

The Initial Statement of Reasons (ISOR) including an informative digest is included in this file.

The original proposed text was made available by GO-Biz for public comment for at least 45 days from September 12, 2014, through October 27, 2014, an additional 15 days from November 1, 2014, through November 17, 2014, and an additional 15 days from December 4, 2014 through December 18, 2014. A total of three written public comments were received.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE INITIAL NOTICE PERIOD OF SEPTEMBER 12, 2014 – OCTOBER 27, 2014

During the initial 45-day comment period GO-Biz received two written public comments. GO-Biz did not receive a request to hold a public hearing. GO-Biz has summarized and responded to the written comments as follows:

Comment #1-California Society of CPAs

Section 8030(g)(2)(H) relating to contingency fee restrictions

Summary of Comment:
The commenter believes Section 8030 (g)(2)(H) will discourage CPAs and other consultants from accepting work on a contingency basis and eliminate a viable and favorable fee arrangement option for small businesses to utilize CPA services when preparing and completing their application. The commenter also indicated the suggested amendment language it submitted with its public comment would affirm GO-Biz’s authority to reject the relatively rare instances of excessive and counterproductive fees as part of CCTC applications, whether those excessive fees are imposed pursuant to an hourly or contingent fee arrangement. The commenter also indicated this provision may adversely impact the program’s goal of fostering fair competition especially for small businesses.

Commenter Suggested Amendment Language:

8030. Application Process for Tax Credit Allocation.
(11) **Estimated** cost of services for consultant

(H) Any other information requested in the application; including, but not limited to, the fee arrangement between the applicant and any consultant, attorney, tax practitioner or any other third party that prepared or submitted the application, or provided any services related to the credit. **Any fee arrangement including a flat fee, a fee calculated based on an hourly rate, or a contingent fee arrangement, that results in total consultant compensation that is unreasonably disproportionate in relation to the amount of the total tax credit requested, such that the total fees paid would unreasonably diminish the jobs-generating benefit of the requested tax credit, may be a basis for rejection of the application.** Any contingent fee arrangement must result in a fee that is less than or equal to the product of the number of hours of service provided to the applicant and a reasonable hourly rate for such services.

**Response to Comment:**

The comment and suggested amendment language were rejected. Allowing finite tax credits to be redirected to excessively high consultant fees is counter to the intent of this program’s authorizing statutes. Subdivision (f) of Section 1 of AB 93 (off code language, un-codified law) clearly states that the Legislative intent and purpose of the CCTC is to attract and retain high-value employers in this state while ensuring the program is a *model of transparency and accountability for the state’s job creation efforts* and the *effective use of taxpayer dollars is maximized.*

The suggested language would not accomplish the goals of the current language that limits a contingent fee to the product of the number of hours of service provided and a reasonable hourly rate for such services. The suggested language is ambiguous and lacks clarity because it would require GO-Biz to come up with a formula for determining or defining how much of a fee would be considered “unreasonably disproportionate” relative to the amount of the credit. Leaving this term (disproportionate) vague and open for interpretation would decrease rather than increase clarity. Even more, quantifying a “proportionate” fee percentage could result in the highest fee structure becoming a floor as opposed to a ceiling, thus resulting in the diversion of even more credits towards fees instead of job creation and economic stimulation. Furthermore, the statement prohibiting consultant fees that “unreasonably diminish the jobs-generating benefit of the requested tax credit” would not control excessive fees. Businesses that request the tax credit would still be required to generate the jobs it agreed to in order to receive the credit, regardless of the consulting fee. However, it could result in applicants committing to create fewer jobs as the credit is redirected from the applicant to the consultant.

In addition, the commenter provided no rationale for the suggested amendment to section 8030(b)(11). GO-Biz finds this amendment unnecessary as well.
Finally, the commenter did not provide any rationale or reason as to how the contingent fee provision in the current language would adversely impact the program’s goal of fostering fair competition especially for small businesses. GO-Biz does not believe this will occur. During the application period (9/29/14-10/27/14) for the credit with the current contingent fee rule in place, GO-Biz received over $33 million in tax credit requests from small businesses with only $11,250,000 available for small businesses.

Comment #2 - City of Moreno Valley

Suggestion Language:

The commenter requested that GO-Biz add three new regulatory requirements. Specifically, it requests that GO-Biz add language to:

1) Prioritize applications from high poverty/unemployment areas in Phase I of the application process
2) Reduce the scope of review of applicants’ previous litigation and violations history
3) “Simplify” the language pertaining to potential audits and recapture provisions for applicants that do not meet their contractual obligations

Response to Comment:

This comment was rejected. The CCTC is a component of the Governor’s Economic Development Initiative (GEDI) and was created by Assembly Bill 93 (Cmte. on Budget, Chapter 69, Statutes of 2013) and Senate Bill 90 (Galgiani, Chapter 70, Statutes of 2013). The CCTC was created in large part to take a statewide systematic look at proposals from businesses that would be evaluated on a competitive basis based on their overall benefit to the State. GO-Biz recognizes that the quantitative Phase I review process could potentially exclude less competitive applicants from areas with high unemployment and/or poverty. This is a significant reason why the CCTC regulations require GO-Biz to review at least the top 200% of applications to ensure credit awards are geographically representative of the state and include applications from areas with high unemployment and poverty, aligned with legislative intent. It should also be noted that in the 2013-14 application period, 2 of the 28 tax credit awards went to applicants whose projects take place in the high unemployment/poverty area of Moreno Valley (the commenter) and over 37% of the total awards went to projects taking place in areas with high unemployment and/or poverty.

As discussed in the ISOR (p13), “GO-Biz considered alternative definitions to strategic importance that would have limited the CCTC to applicants located in specific high poverty and/or unemployment census tracts. This option was rejected as too restrictive since even geographic areas with relatively low percentages of unemployed residents could still have high numbers of unemployed individuals who could benefit from projects that propose to create jobs that mesh with the demographic and educational levels of these unemployed individuals.”

This commenter cites Section 1 of AB 93 as legislative intent for the CCTC program to give a priority to former Enterprise Zones and other areas of the state suffering from high rates of unemployment and
poverty. However, another component of GEDI also authorized by AB 93, the New Employment Credit, specifically requires applicants to be located in areas with high poverty and high unemployment census tracks or former Enterprise Zones, excluding wealthy areas within those zones. There is no such requirement for the CCTC program that would limit the credit to such areas.

The comments regarding litigation and potential audits were also rejected as they are attempting to solve a problem that does not exist. GO-Biz recognizes that a significant percentage of businesses at one point or another have been subject to litigation or cited for a violation. It is possible and even likely that an applicant’s prior litigation or regulatory compliance issues could be raised by a member of the public at the CCTC Committee Meeting. Under the Bagely-Keene Act and the provisions of the CCTC statutes, the CCTC Committee is required to approve or reject all credit agreements, and allow for public comments. By requiring an applicant to disclose these past violations, GO-Biz can work with the applicant to confirm the nature of the pending or resolved violation(s) or litigation, and thus be able to refute or respond to any individual or group that asserts via public comment that these issues should be used as a rationale for denying a credit.

With regards to the concern the commenter makes about potential audits, Revenue and Tax Codes 17059.2 (d)(1)(A) and 23689(d)(1)(A) require the Franchise Tax Board (FTB) to review the books and records of all large business CCTC recipients to ensure compliance with the terms of the contractual credit agreements. They also authorize but do not require FTB to review the books and records of small business CCTC recipients. These sections go on to prescribe the method for recapturing credits from applicants/recipients that fail to comply with their written contractual arrangement with GO-Biz.

GO-Biz does not have the authority through regulations, as the commenter requests, to reduce or eliminate these statutory requirements. These code sections were intentionally duplicated (please see page 11 regarding duplication explanation) in the regulations to provide clarity to applicants and enable businesses to be aware of these requirements without having to reference back to the CCTC’s authorizing legislation.

AMENDMENTS MADE TO THE PROPOSED REGULATIONS AFTER THE 45-DAY COMMENT PERIOD ENDED ON October 27, 2014

Sections 8000 and 8030 were amended October 31, 2014, to clarify application requirements based on questions received from and challenges encountered by CCTC applicants during the first application period in the spring of 2014. CCTC stakeholders and interested parties were appropriately noticed of these amendments and provided 15 days to comment on October 31, 2014, and the revised text was made available on the GO-Biz website and as otherwise required.

Section Affected: Chapter 13, Article 1, Section 8000(a)(1)(3) and (b)(2).

Issues Being Addressed:

A number of definitions [i.e., (a)(1)(3) Aggregate Employee Compensation, (b)(2) Aggregate Investment] were modified to explicitly inform applicants that if they were previously awarded a credit under the
CCTC program and wish to apply again that they will be evaluated based on their new compensation and investment commitments. When applicants are awarded a credit through the CCTC, they sign a contract with GO-Biz that clearly lays out the activities they must perform and milestones they must achieve in order to earn their tax credit. On its face, this would seem to be a matter of common sense and not require clarifying. That said, based on questions received from applicants during the first application period, GO-Biz has modified the regulations to make it clear that an applicant cannot be compensated or awarded a credit multiple times for activities it has already been contractually obligated and compensated to perform through a previously ratified CCTC contract with GO-Biz.

**Anticipated Benefits from this Regulatory Action:**

These additions to the definitions of “Aggregate Employee Compensation” and “Aggregate Investment” ensure applicants have a clear and consistent understanding that while there is no limit to the number of times a business can apply for or receive a tax credit through this program, additional credits must be based on new full-time employees and investments above and beyond those that an applicant committed to for a previous CCTC award and contract.

**Underlying Data:**

There are numerous definitions of contracts in legal texts and online sources. They generally state that a contract is “an agreement with specific terms between two or more persons or entities in which there is a promise to do something in return for a valuable benefit known as consideration.” State agencies and departments sign contracts with businesses in California on a regular basis whereby the state “promises” to pay the private entity in exchange for the services or goods (“benefit”) the entity will provide to the state. For purposes of the CCTC, the “benefit” to the state is the jobs being created and investments being made by businesses who in “return” receive a tax credit.

Subdivision (f) of Section 1 of AB 93 (off code language, un-codified law) clearly states that the legislative intent and purpose of the CCTC is to attract and retain high-value employers in this state while ensuring the program is a model of transparency and accountability for the state’s job creation efforts and the effective use of taxpayer dollars is maximized. Allowing finite tax credits to be awarded multiple times for the same activities is counter to the intent of this program’s authorizing statutes and is untenable.

**Consideration of Alternatives:**

GO-Biz considered leaving the original definition of “aggregate employee compensation” and “aggregate investment” in place. This option was rejected. The amendments were necessary to ensure that applicants clearly understand that they cannot receive a credit multiple times for activities which they have already agreed to perform in a legally binding contract.

**Section Affected: Chapter 13, Article 1, Section 8000 – Definitions.**

**Issues Being Addressed:**

GO-Biz has also modified the following definitions:
• (k) Base Year – is generally (and was previously defined as) the applicant’s most recently completed tax year. The CCTC application process provides a methodology to ensure that all applicants provide quantitative employee growth figures in a consistent manner to allow GO-Biz to effectively evaluate and compare applications. Base Year was modified through these regulations (k)(2) to clarify that if an applicant has already received a credit, the base year for future applications will be the base year that the applicant used when it first was awarded a CCTC. Revenue and Taxation Code 17059.2(a)(2)(A) and 23689(a)(2)(A) specifically charge GO-Biz with allocating tax credits to California businesses based in part on “the number of jobs the taxpayer will create or retain in the state” (emphasis added).

• (q) Current Taxable Year – this term is used in the CCTC application and is commonly used in the business and accounting professions. A definition was added to the regulations to clarify that the applicant’s current taxable year is the based on the applicant’s taxable year as of the submission deadline for a given application period. Many businesses operate on a calendar year (January 1 – December 31) basis for accounting/tax purposes. This definition is helpful and provides clarity for businesses that operate on a fiscal year basis.

Anticipated Benefits from this Regulatory Action:

These definitions ensure applicants have a clear and consistent understanding of the information that is being requested for purposes of calculating the Phase I ratio, thereby creating a standardized review process. Absent clear definitions, applicants fail to have systematized information that could impact the entire field of applicants. Section 8030 prescribes the application process and criteria for evaluating applications in two phases. As previously stated in the ISOR, Phase I of the evaluation process is an automated process that yields the rate of return (benefit) to the state by calculating a ratio that divides the amount of tax credit requested by an applicant by the sum of its “aggregate employee compensation” and “aggregate investment”. A misinterpretation of these inputs could result in an inaccurate comparison of the applicants. These non-substantive edits were necessary for consistency throughout the regulations and to improve clarity regarding the application and evaluation process.

Underlying Data:

GO-Biz did not review or analyze any underlying data for these definitions.

Consideration of Alternatives:

GO-Biz considered leaving the original definition language in place. This option was rejected as input from applicants during the application process indicated that providing greater clarity and aligning the regulations with the online application would yield more consistent and accurate information for purposes of conducting evaluations.

GO-Biz considered not defining “Current Taxable Year” but this option was rejected. This is a very common term used by businesses, accountants, and other tax professionals. This definition was added to provide clarity since the term is used throughout the regulations and application process.
Section Affected: Chapter 13, Article 1, Section 8030 – Application Process for Tax Credit Allocation.

Issues being addressed:

- (b)(4) Contact person – this information request was modified to provide clarity and a broader requirement to include that in the event a consultant is assisting with the preparation of the application, the applicant needs to identify at least one contact who is an employee or owner of the applicant company.
- (b)(7) – makes the information requested regarding the size of the applicant consistent with the definition of small business in Section 8000 by clarifying that applicants need to indicate whether they had in the previous taxable year no gross receipts, $2 million or greater in gross receipts, or less than $2 million but greater than zero gross receipts.
- (b)(27) – a minor grammatical change was made to clarify that applicants should identify if any “new” employees or investments are a result of a transfer from “any member” of a controlled group of corporations. This change does not alter the intent of this section but rather clarifies that “new” means additional jobs or investments and not a transfer of existing employees or property between commonly controlled entities.
- (b)(35) – greater detail is provided to be consistent with how the questions are asked in the application without changing the intent of what is being requested with regards to the number of full-time employees an applicant is proposing to hire on an annual full-time equivalent basis.
- (b)(49)(50) – applicants need to provide information regarding their “accounting period” and “current taxable year” in order for GO-Biz to determine eligibility. These additions simply make clear that GO-Biz needs to request this information in order to effectively evaluate applications.
- (b)(51 – 55) – provide specificity and clarity regarding the information an applicant needs to provide to quantify the number of full-time employees it will be hiring, and employing, determined on an annual full-time equivalent basis. This is not a new requirement. These subsections clarify how the previously defined term of “annual full-time equivalents” are calculated and makes the regulations consistent with how the questions are asked in the online application.
- (b)(56) – clarifies that GO-Biz is requesting an applicant’s investments for the same tax year’s that are included in the definition of “aggregate investment” in Section 8000.
- (b)(57) – GO-Biz has added a question to the application as to whether applicants not awarded a credit would like for GO-Biz to contact them to offer assistance in identifying other programs and incentives that might be available to the applicant. This item is included in the regulations to ensure consistency between the regulations and the application questions.

Anticipated Benefits from this Regulatory Action:

The information applicants are required to submit as part of the application ensures that GO-Biz receives clear and consistent information from each applicant. This allows GO-Biz staff to conduct fair and transparent evaluations that lead to credit recommendations for the most competitive applicants providing the greatest economic benefit to the State. This section also provides mechanisms to ensure
that credits are only awarded to the applicants that meet the statutory evaluation criteria and that have the highest need and likelihood of project success.

Underlying Data:

GO-Biz did not review or analyze any underlying data for these definitions.

Consideration of Alternatives:

GO-Biz considered leaving the original regulatory language in place. This option was rejected as input from applicants during the application process indicated that providing greater clarity and aligning the regulations with the online application would provide more consistent and accurate information for purposes of conducting evaluations.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE 15-DAY NOTICE PERIOD OF NOVEMBER 1, 2014 – NOVEMBER 17, 2014

A 15-day notice was issued on October 31, 2014, to mirror the CCTC emergency regulations that were also noticed on October 31, 2014 and amended and readopted on November 17, 2014. GO-Biz received one public comment during this period.

Comment #1-City of Moreno Valley

Suggestion Language:

The commenter requested that GO-Biz add a new regulatory requirement to prioritize applications from high poverty/unemployment areas in Phase I of the application process.

Response to Comment:

For the response to this comment, which is virtually identical to the previously discussed comment from the City of Moreno Valley received during the 45 day public comment period, please see our previous response discussed on pages 3-4 of this Final Statement of Reasons (FSOR).

AMENDMENTS MADE TO THE PROPOSED REGULATIONS AFTER THE 15-DAY COMMENT PERIOD ENDED ON November 17, 2014

Section 8030 was amended and publicly noticed for 15 days beginning December 3, 2014, based on informal feedback received from CCTC applicants outside of the official public comment process with regards to the unanticipated consequences of the Phase I evaluation process for publicly held companies. An additional amendment was made as a result of an inadvertent posting of the wrong document of the text of regulations during the previous two public comment periods. CCTC
stakeholders and interested parties were appropriately noticed of these amendments and provided 15 days to comment on December 3, 2014, and the revised text was made available on the GO-Biz website and as otherwise required.

**Section Affected:** Chapter 13, Article 1, Section 8030 – Application Process for Tax Credit Allocation.

**Issues being addressed:**

(g)(1) Phase I – As discussed in the ISOR, applicants are ranked via a quantitative ratio in Phase I and at least the top 200% are moved into Phase II. In addition, “retention” applicants are automatically moved into Phase II based on their contention that California will lose new or existing employees absent award of this credit. In the previously noticed (September 12, 2014) version of these regulations, GO-Biz required applicants to assert that absent award of the credit, the project “will” take place in another state or the applicant “will” terminate or relocate all or a portion of its California employees. The amended regulations change the word “will” to “may”.

**Anticipated Benefits from this Regulatory Action:**

Changing the “will”s to “may”s will ensure that publicly held companies are more comfortable applying for the CCTC program without worrying that they would be held to a higher standard than their non-publicly held competition. As a result, this change will improve the competitive pool of CCTC applicants and contribute to an open and transparent process.

**Underlying Data:**

Publicly traded companies cannot attest to GO-Biz that, absent award of a credit, they will relocate employees or expand in another state (other than California) without running awry of requirements imposed by the Securities and Exchange Commission, shareholders, and other obligations to which publicly held companies are subject. Companies that are publicly owned, on the other hand, are subject to detailed disclosure laws about their financial condition, operating results, management compensation, and other areas of their business. While GO-Biz did not receive official public comment on this issue, it did receive feedback throughout the regular course of business in which this concern was raised.

**Consideration of Alternatives:**

GO-Biz considered leaving the regulations in place, requiring applicants to attest that they “will” relocate or terminate employees absent the credit. This option was rejected as it created an un-level playing field for publicly held applicants and might discourage otherwise competitive businesses from applying.

**Issue Being Addressed:**

(g)(2)(H) consultant fee arrangement – this modified section specifies as part of the evaluation process the “reasonableness” of the fee arrangement with consultants will be evaluated. It also specifies that
any contingency fee arrangement must equate to a fee that is less than or equal to the product of the number of hours of service provided to the applicant and “a reasonable hourly rate” for such services. The language is already discussed in the ISOR. This modification was publicly noticed on December 3, 2014 as a result of an inadvertent posting of the wrong document during the first two public comment periods. It should also be noted that both the ISOR and the one public comment on this section reference the original language which is in the already approved emergency regulations and is consistent with the language in this publicly noticed version.

Underlying Data:

Please see the analysis of this section in the ISOR which includes a discussion of legislative intent language supporting this requirement.

Alternatives Considered:

Please see the discussion on this subject in the ISOR.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE 15-DAY NOTICE PERIOD OF DECEMBER 4, 2014 – DECEMBER 18, 2014

No public comments were received.

ALTERNATIVES DETERMINATION

GO-Biz has determined that no alternative to these proposed regulations would be more effective in carrying out the purpose for which the regulations are proposed or would be as effective and less burdensome to affected private persons than the proposed regulations or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law. Alternatives considered are discussed throughout this document and the ISOR.

LOCAL / SCHOOL DISTRICT MANDATE DETERMINATION

The proposed regulations do not impose any mandate on local agencies or school districts.

SMALL BUSINESS IMPACT

This action will not have a significant adverse economic impact on small businesses. Please see the description of the positive impacts for all businesses, including small businesses, as discussed in the ISOR.

NONDUPLICATION STANDARD (1 CCR sec. 12(b)(1))

The proposed regulation duplicates or overlaps a state or federal statute or regulation which is cited as “authority” or “reference” for the proposed regulation and the duplication or overlap is necessary to satisfy the “clarity” standard of Government Code Section 11349.1(a)(3).
In connection with these proposed regulations, GO-Biz determined that it was necessary to duplicate language from Revenue and Taxation Code sections 17059.2 and 23689 in order to avoid gaps in the regulation which would otherwise exists if sections were not duplicated. By duplicating language, it is clearer for the reader to understand the application process of the CCTC and minimizes the need for the reader to have to refer to multiple code sections. Including the duplication of certain sections was necessary in order to meet the clarity standard.

The CCTC program is available to literally any taxpaying business in the State. Twenty-five percent of the program’s funds are specifically reserved for small businesses with greater than zero and less than $2 million in gross receipts. These small businesses frequently do not have the technical sophistication to cross-reference the enabling statutes and regulations for this program. Far too often, government is criticized for not being “business friendly” and making application processes confusing or unwieldy. Therefore, to provide clarity to the business community, a portion of these regulations duplicate language from the program’s enabling statutes.

**NONSUBSTANTIVE CHANGES MADE TO REGULATION TEXT DURING OAL REVIEW**

Several nonsubstantive changes were made to the regulation text during OAL review that were solely grammatical in nature.