

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Revenue & Tax Committee Analyst: LuAnna Hass Bill Number: SB 1185

Related Bills: See Legislative History Telephone: 845-7478 Amended Date: 07/03/2001

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: FTB Legislative Proposals

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended April 19, 2001.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended April 19, 2001.
- FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 19, 2001 STILL APPLIES.
- OTHER - See comments below.

SUMMARY

This Franchise Tax Board (FTB) sponsored bill would:

- rename the "Bank and Corporation Tax Law" as the "Corporation Tax Law,"
- make California law substantially the same as the federal law that permits electronic postmarks to be proof of the date an e-file return is filed,
- add multi-jurisdictional trusts as participants in the FTB voluntary disclosure program,
- allow FTB to initiate action on taxpayer accounts that are overpaid,
- specify that taxpayers taking the federal election to treat a stock purchase as an asset purchase would not trigger a recapture of the Manufacturers' Investment Credit,
- delete an obsolete term from the income tax laws, and
- amend the definition of "qualified employee" for specified economic development areas and clarify the vouchering requirements.

SUMMARY OF AMENDMENTS

The July 3, 2001, amendments resolved the department's technical considerations by accepting the amendments suggested in the department's analysis of the bill as amended April 19, 2001.

Specifically, these amendments would:

Board Position:

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Department Director

Date

Brian Putler

07/23/01

- rename Part 11 of Division 2 of the Revenue and Taxation Code (R&TC) as the Corporation Tax Law,
- rename Chapter 2 of Part 11 of Division 2 of the R&TC as the Corporation Franchise Tax, and
- include an additional cross-reference within the R&TC section regarding the mailing of income tax returns.

The July 3 amendments also added provisions that would:

- delete an obsolete term from the income tax laws administered by the FTB.
- amend the definition of “qualified employee” for specified economic development areas (EDAs) and clarifying the vouchering requirements.

The new provisions are discussed separately in this analysis. The revenue impact and the unresolved implementation consideration regarding the Manufacturers’ Investment Credit from the department’s analysis of the bill as amended April 19, 2001, are included below for convenience. As a result of the July 3 amendments, the department has identified technical considerations that are discussed in this analysis. The remainder of the department’s analysis of the bill as amended April 19, 2001, still applies.

POSITION

Support.

The Franchise Tax Board voted at its December 18, 2000, meeting to sponsor the language introduced in this legislation.

Summary of Suggested Amendments

Amendments are provided to address the department's implementation and technical concerns.

TOTAL ECONOMIC IMPACT

This bill would result in revenue gains as shown in the following table.

| Estimated Revenue Impact of SB 1185 As Amended 7/3/01 [\$ In Millions] | | | |
|--|-----------------|-----------------|-----------------|
| Provision | 2001-02 | 2002-03 | 2003-04 |
| Replace "income year" with "taxable year" | no impact | no impact | no impact |
| Rename "Bank and Corporation Tax Law" as the "Corporation Tax Law" | no impact | no impact | no impact |
| Electronic postmarks | no impact | no impact | no impact |
| Vouchering requirements | no impact | no impact | no impact |
| Expand voluntary disclosure program to trusts | \$1.0 | \$1.0 | \$1.0 |
| Revenue agent report refund statute | -\$0.5 | -\$0.5 | -\$0.5 |
| MIC recapture exception | negligible loss | negligible loss | negligible loss |
| Total | negligible gain | negligible gain | negligible gain |

Negligible is gain or loss of less than \$250,000.

MANUFACTURERS' INVESTMENT CREDIT (MIC) RECAPTURE EXCEPTION

IMPLEMENTATION CONSIDERATION

For purposes of the MIC, this bill would state that the sale of stock "may" not be treated as a disposition of qualified property. The use of the phrase "may" gives the appearance that an option exists and that the stock could be treated as a disposition of qualified property. This could lead to confusion with taxpayers, as the language doesn't address when the taxpayer may take either option. Amendment 5 is provided to replace the word "may" with "shall."

DELETE OBSOLETE TERM "INCOME YEAR" FROM THE INCOME TAX LAWS

PURPOSE OF THE BILL

FTB is sponsoring this provision as a technical measure to clean up the law and make the use of terms consistent.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2002, and would apply to taxable years beginning on or after that date.

ANALYSIS

STATE LAW

As a result of AB 1843 (Stats. 2000, Ch. 862), the franchise tax, like the income tax¹, is now computed based on the net income for the taxable year, instead of based on the net income of the preceding income year. To the extent a provision of law refers to a calendar year or fiscal year beginning prior to January 1, 2000, upon the basis of which net income is computed, the term "taxable year" means "income year" under prior law.

THIS BILL

This bill would replace the obsolete term "income year" with "taxable year" in all appropriate Revenue and Taxation Code sections administered by the department.

IMPLEMENTATION CONSIDERATIONS

Implementation of this bill would occur during the department's normal annual system update.

TECHNICAL CONSIDERATIONS

Amendments 1 and 4 are provided to correct references from "income" year to "taxable" year.

This bill would rename the federal Job Training Partnership Act (JTPA) as the federal Workforce Investment Act of 1998 within one provision of the R&TC relating to EDA's. Since the R&TC contains several provisions relating to EDA's that reference the JTPA, Amendment 3 would reverse the title change suggested in this bill in order to maintain consistency within the R&TC.

Amendment 2 is provided to correct the reference from "taxable" to "income" in one law where the obsolete term should be retained for historical reference.

LEGISLATIVE HISTORY

AB 1843 (Ackerman, Stats. 2000, Ch. 862), sponsored by FTB, eliminated the term and concept of "income year."

BACKGROUND

The franchise tax is imposed on a corporation for the privilege of exercising its corporate franchise in this state. Under prior state law, the franchise tax was measured by the income of the corporation in the prior year. The period for which the income was measured was called the "income year" and the period for which the tax was paid was the "taxable year."

¹ Under California law, the corporate income tax is imposed on corporations that are not doing business in California but are receiving income from California sources that is taxable in the year received or accrued. Thus, for corporate income tax purposes the period of the income measurement year and the period of the taxable year have always coincided.

Prior to January 1, 2000, when a corporation incorporated, qualified to transact business, or began doing business in the state, the franchise tax for its first taxable year was the prepaid minimum franchise tax. A corporation's income for the first year formerly served as the measure of the tax for the second taxable year, and the income of each succeeding year served as the measure of tax for the next following year. Thus, the income year preceded the taxable year of the corporation by one year.

AB 1843 (Stats. 2000, Ch. 862) eliminated the term and concept of "income year" from the Personal Income Tax Law (PITL), the Administration of Franchise and Income Tax Laws (AFITL) and the Bank and Corporation Tax Law (B&CTL). The sole purpose of AB 1843 was to simplify the law; the actual amount of tax and the timing of the payment did not change.

AB 1843 contained language to prevent chaptering issues with other bills. The language specified that if any other act was enacted that amended one or more of the same code sections as AB 1843, that act would prevail for those code sections. As a result, 10 code sections from AB 1843 that were "chaptered out" by other bills still contain "income year" rather than the appropriate "taxable year." In addition, there was a new code section added to the Revenue and Taxation Code by another bill that contained the term "income year" and five code sections that were inadvertently omitted from AB 1843.

OTHER STATES' INFORMATION

Information on other states is not relevant as this provision makes minor technical changes for code maintenance purposes.

FISCAL IMPACT

This provision would not impact the department's costs.

ECONOMIC IMPACT

This provision would not impact the state's income tax revenue.

ARGUMENTS

This provision would remove an obsolete term from various sections within the Code and replace it with the appropriate term. Maintaining the Code to delete obsolete terms reduces taxpayer confusion.

EMPLOYER HIRING CREDIT/VOUCHERING REQUIREMENT

PURPOSE OF THE BILL

FTB is sponsoring this provision to clarify the vouchering requirements of new employees who qualify for EDA credits and clarify the meaning of "qualified employee."

EFFECTIVE/OPERATIVE DATE

This provision would be effective January 1, 2002, and operative for taxable years beginning on or after that date.

ANALYSIS

STATE LAW

Under existing state law, taxpayers operating in an EDA are allowed a hiring credit for hiring “qualified employees.” A “qualified employee” is generally defined by reference as a person who qualifies for at least one of various state or federal public assistance programs.

Existing enterprise zone (EZ), local area military base recovery area (LAMBRA), and targeted tax area (TTA) statutes require taxpayers/employers to obtain vouchers for each new hire to be eligible for the hiring credit. Vouchers are issued by a federal or state agency familiar with the public assistance statutes that comprise the definition of “qualified employee.” A voucher is used by FTB at audit to verify that the prospective employee is eligible for or is receiving one of the specified forms of public assistance and thus is a “qualified employee.” Existing manufacturing enhancement area (MEA) statutes do not require taxpayers to obtain a voucher to be eligible for the hiring credit.

THIS BILL

Qualified Employee Definition

This bill would clarify the definition of “qualified employee” by adding a specific reference to the definitions of the federal Job Training Partnership Act (JTPA) as they existed on and before June 30, 2000.

Vouchering Requirement

This bill would clarify that there must be a voucher for each new employee by adding the vouchering requirement to the definition of “qualified employee.”

This bill would allow a taxpayer the opportunity to substantiate independently that an employee is a “qualified employee” where no vouchering process has been established.

IMPLEMENTATION CONSIDERATIONS

This provision would improve the department’s ability to administer the laws relating to the EDA hiring credits by specifying the vouchering requirement and by providing the department necessary flexibility in circumstances where no voucher can be obtained due to no fault of the taxpayer. These changes could be implemented during the department’s normal annual update.

LEGISLATIVE HISTORY

AB 2895 (Assembly Revenue and Taxation Committee, Stats. 2000, Ch. 864) amended the LAMBRA and MEA hiring credit statutes to include a vouchering requirement. However, the vouchering requirement for the MEA added by AB 2895 was chaptered out of law by SB 1445 (Kelley, Stats. 2000, Ch. 865).

PROGRAM BACKGROUND

Qualified Employee Definition

The hiring credits allowed to taxpayers in EDAs may be claimed by an employer (the taxpayer) for a percentage of wages paid to a new employee. The taxpayer may claim a hiring credit only for a "qualified employee." A "qualified employee" is defined as a person who falls within an extensive list of economically disadvantaged individuals. This list includes individuals who are recipients of assistance under several specifically named federal and state public assistance programs. One of those programs is the federal JTPA.

In 1997, the Trade and Commerce Agency (TCA) became concerned about the pending expiration of JTPA. TCA was concerned that the statutory basis for determining whether a new employee was a "qualified employee" would cease to exist when JTPA expired. TCA requested that the R&TC definition of "qualified employee" be amended by adding paraphrased versions of the underlying definitions of persons eligible for JTPA under federal law. Accordingly, legislation was enacted that defined "qualified employee" with the extensive list of economically disadvantaged individuals.

Vouchering Requirement

The hiring credit statutes provide that the taxpayer "shall" obtain and retain a certification (voucher) document that certifies that a new employee met the eligibility requirement of a "qualified employee." The intent of the vouchering requirement was to make receipt of a voucher a prerequisite to claiming the credit. The voucher is used to track and control the value of the EDA programs by TCA and to promote consistent application of the elements that must be satisfied to receive the hiring credit.

OTHER STATES' INFORMATION

A review of other state tax laws is not relevant to this provision since it makes only minor technical changes to current state law.

FISCAL IMPACT

This provision would not impact the department's costs.

ECONOMIC IMPACT

This provision would clarify current law hiring credit conditions. No further revenue impact would result.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1185
As Amended July 3, 2001

AMENDMENT 1

On page 48, line 8, after "SEC.10." insert:

Section 19147 of the Revenue and Taxation Code is amended to read:

19147. (a) Notwithstanding Sections 19142 to 19145, inclusive, the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax paid on or before the last date prescribed for the payment of the installment equals or exceeds the amount which would have been required to be paid on or before that date if the estimated tax were whichever of the following is the lesser:

(1) (A) The tax shown on the return of the taxpayer for the preceding taxable year if a return showing a liability for tax was filed by the taxpayer for the preceding year and that preceding year was a year of 12 months. The tax shown on the return, in the case of the tax imposed by Article 3 (commencing with Section 23181) of Chapter 2 of Part 11, means the amount of tax shown on the return for the taxable year as prescribed in Section 19021.

(B) In the case of a large corporation, subparagraph (A) shall not apply, except as provided in clauses (i) and (ii).

(i) Subparagraph (A) shall apply for purposes of determining the amount of the first required installment for any taxable year.

(ii) Any reduction in the first required installment by reason of clause (i) shall be recaptured by increasing the amount of the next required installment by the amount of that reduction.

(2) (A) An amount equal to the applicable percentage specified in Section 19144 of the tax for the taxable year computed by placing on an annualized basis the taxable income:

(i) For the first three months of the taxable year, in the case of the installment required to be paid in the fourth month.

(ii) For the first three months of the taxable year, in the case of the installment required to be paid in the sixth month.

(iii) For the first six months of the taxable year in the case of the installment required to be paid in the ninth month.

(iv) For the first nine months of the taxable year, in the case of the installment required to be paid in the 12th month of the taxable year.

(B) (i) If the taxpayer makes an election under this clause, each of the following shall apply:

(I) Clause (i) of subparagraph (A) shall be applied by substituting "two months" for "three months."

(II) Clause (ii) of subparagraph (A) shall be applied by substituting "four months" for "three months."

(III) Clause (iii) of subparagraph (A) shall be applied by substituting "seven months" for "six months."

(IV) Clause (iv) of subparagraph (A) shall be applied by substituting "ten months" for "nine months."

(ii) If the taxpayer makes an election under this clause, each of the following shall apply:

(I) Clause (ii) of subparagraph (A) shall be applied by substituting "five months" for "three months."

(II) Clause (iii) of subparagraph (A) shall be applied by substituting "eight months" for "six months."

(III) Clause (iv) of subparagraph (A) shall be applied by substituting "eleven months" for the "nine months."

(iii) An election under clause (i) or (ii) shall apply to the taxable year for which the election is made and shall be effective only if the election is made on or before the date required for the payment of the first required installment for that taxable year.

(iv) This subparagraph shall apply to ~~income~~ taxable years beginning on or after January 1, 1997.

(C) For purposes of this paragraph, the taxable income shall be placed on an annualized basis in the following manner:

(i) Multiply by 12 the taxable income referred to in subparagraph (A).

(ii) Divide the resulting amount by the number of months in the taxable year referred to in subparagraph (A).

"Taxable income" as used in this paragraph means "net income" includable in the measure of tax or "alternative minimum taxable income" (as defined by Section 23455).

(D) In the case of any corporation which is subject to the tax imposed under Section 23731, any reference to taxable income shall be treated as including a reference to unrelated business taxable income and, except in the case of an election under subparagraph (B), each of the following shall apply:

(i) Clause (i) of subparagraph (A) shall be applied by substituting "two months" for "three months."

(ii) Clause (ii) of subparagraph (A) shall be applied by substituting "four months" for "three months."

(iii) Clause (iii) of subparagraph (A) shall be applied by substituting "seven months" for "six months."

(iv) Clause (iv) of subparagraph (A) shall be applied by substituting "ten months" for "nine months."

(3) The applicable percentage specified in Section 19144 or more of the tax for the taxable year was paid by withholding of tax pursuant to Section 18662.

(4) The applicable percentage specified in Section 19144 or more of the net income for the taxable year consists of items from which an amount was withheld pursuant to Section 18662, the amount of the first installment under Section 19025 equals at least the minimum franchise tax specified in Section 23153, and the amount of any installment under Section 19025 includes an amount equal to the applicable tax under Section 23800.5.

(b) (1) For purposes of this section, "large corporation" means any corporation if that corporation (or any predecessor corporation) had taxable income (computed without regard to net operating loss deductions) of one million dollars (\$1,000,000) or more for any taxable year during the testing period.

(2) For purposes of this subdivision, "testing period" means the three taxable years immediately preceding the taxable year involved.

Sec. 11

@@@@@ LEG COUNSEL renumber remaining Sections of the bill.

AMENDMENT 2

On page 64, line 31, strikeout "taxable" and insert:

"income"

AMENDMENT 3

On page 94, strikeout lines 6 and 7, and insert:

Job Training Partnership Act (29 U.S.C. Sec. 1501 et seq.), or its successor.

AMENDMENT 4

On page 118, line 38, strikeout "income" and insert:

taxable

AMENDMENT 5

On page 133, line 10, strikeout "may" and insert:

shall