

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Dunn Analyst: Kristina E. North Bill Number: SB 268  
Related Bills: See Legislative History Telephone: 845-6978 Introduced Date: February 16, 2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Employer Provided English As A Second Language Classes Credit/FTB Report to Legislative Annually

## SUMMARY

This bill would create a tax credit for employers that provide English as a second language classes to employees.

## PURPOSE OF THE BILL

The author's office has indicated that the purpose of this bill is to create an incentive for employers to provide English as a second language classes to their employees to increase productivity, job safety, and employee advancement.

## EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The credit would apply to taxable years beginning with January 1, 2002, and before January 1, 2008.

## POSITION

Pending.

## ANALYSIS

### FEDERAL/STATE LAW

**Current state and federal laws** provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

**Current state and federal laws** permit a deduction for ordinary and necessary expenses incurred in a trade or business. Although a work-related literacy program would qualify for such a *deduction*, neither state nor federal laws provide a tax *credit* for expenses related to improving the literacy skills of employees.

Board Position:

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Department Director

Date

Alan Hunter for GHG

04/04/01

## THIS BILL

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, **this bill** would authorize a credit equal to an unspecified percentage of the amount paid or incurred by an employer for providing English as a second language classes to employees on the employer's premises.

**This bill** would define "qualified expenses" as amounts paid or incurred by a taxpayer for expenses incurred in connection with providing a safe, clean, and quiet space for offering English as a second language class. These expenses would include the cost of lighting, heating, cooling, cleaning, necessary furniture, and instructional materials. Qualified expenses also would include expenses paid or incurred for the wages of a qualified instructor to conduct the English as the second language classes.

**This bill** would limit the credit to expenses paid or incurred in connection with employees located in this state.

**This bill** would specify that no deduction would be allowed for the same expenses for which this credit was allowed.

**This bill** would allow any unused credit to be carried over until exhausted.

**This bill** would require the Franchise Tax Board (FTB) to report annually to the Legislature on or before January 1st in 2004 to 2009, the number and dollar amounts of credits claimed and the number of employers allowed this credit. This bill also would require FTB, if possible, to include information on the number of employees participating in English as a second language classes.

## IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- This bill uses terms and phrases that are undefined, i.e., "employee," "safe, clean, and quiet space," "necessary furniture," "instructional materials," and "qualified instructor." For example, this bill could be interpreted to allow an employer to claim the credit for an employee other than the employer's employee. The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.
- This bill does not specify if the term "wages" paid to a qualified instructor would apply to amounts that generally are not considered wages paid to an independent contractor or amounts paid to a business providing English language instruction services.
- This bill does not provide standards for employee participation in the classes. Standards would provide clearer guidelines to taxpayers and would help prevent disputes between the department and taxpayers. Standards would be helpful in the following areas:
  1. The employee must have an English deficiency upon entering and a required English proficiency level upon completion of the classes;

2. A required level of expertise for the trainers, such as credentialed teachers or other criteria that the author may set; and
  3. A minimum and maximum length of time for the English as a second language class should be provided that would generally attain the required English proficiency targeted for this credit.
- Since this department does not have the expertise to administer programs such as English as a second language or other educational programs, it would be helpful if an agency such as the Department of Education (DOE) certified that the employer-provided training programs met the bill's requirements.
  - This bill does not limit the number of years of the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover limit since experience shows credits typically are exhausted within eight years of being earned.

### TECHNICAL CONSIDERATION

This bill requires FTB to annually report the "number and dollar amounts of credits claimed" and the "number of employers allowed this credit." Generally, FTB would report on the number of credits and dollar amounts allowed to taxpayers for a credit. The amount "claimed" and the amount "allowed" are two different numbers based on various factors including actual tax liability. It is unclear if the author would like to the FTB to report the actual number and dollar amounts of credits allowed to employers for this credit.

### **LEGISLATIVE HISTORY**

**AB 2849** (Bordonaro, 1995/1996) would have authorized a credit for employers equal to 15% of the amount paid or incurred during the taxable year for an employee's qualified language training expenses. The credit would have been limited to \$400 per employee. This bill failed passage in the Senate Revenue and Taxation Committee.

**SB 1227** (Haynes, 1995/1996) would have authorized a credit for employers equal to 50% of the amount paid or incurred during the taxable year for an employee's qualified language training expenses. This bill failed passage out of the house of origin before January 31<sup>st</sup> of the second year of the session.

**SB 1573** (Hurt, 1993/1994) would have authorized a credit for employers equal to 50% of the amount paid or incurred during the taxable year for an employee's qualified language training expenses. The credit would have been limited to \$1,000 per employee. This bill failed passage in the Senate Revenue and Taxation Committee.

### **OTHER STATES' INFORMATION**

**Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York** do not offer a tax credit for costs incurred for an employee's English as a second language class. These states were selected for comparison because of similarities to California tax law.

## **FISCAL IMPACT**

With the resolution of the implementation concerns, this bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### Tax Revenue Estimate

This bill does not specify a credit percentage amount. For this analysis a credit percentage of 25% was used, generating a revenue loss of \$14 million annually beginning in 2001/2002.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

### Tax Revenue Discussion

The revenue impact for this bill will be determined by the number of qualified employers, the average qualifying expenses, and the tax liabilities of claimants.

The estimate was developed in the following steps. First, according to the State Department of Education, there are an estimated 3.4 to 11 million functionally illiterate adults in California whose average English proficiency level is at or below the 6<sup>th</sup> grade level. Second, since the information obtained shows the number of functionally illiterate adults in a large range, it was assumed that 5 percent of the minimum number (170,000 ([3.4 million x 5%]) would qualify private sector employers for the credit in any given year. Third, according to the same source, the average cost to train an individual is approximately \$500. This yields an average credit of \$125 (\$500 x 25%). Fourth, this estimate was adjusted to account for denial of current law deductions for these expenses.

## **POLICY CONCERNS**

This bill does not require the employee to complete the training or obtain a specified level of proficiency prior to the employer's receipt of a credit.

This bill would allow full-time, part-time, or seasonal employees to qualify the taxpayer for the credit. Also, relatives of the employer would qualify if they were employees.

## **LEGISLATIVE STAFF CONTACT**

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