Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Aramabula Analyst: Darrine Distefano Bill Number: AB 2502

Related Bills: See Prior Analysis Telephone: 845-4142 Amended Date: April 20, 2006

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Small Business Tax Credit Transfers To Other Taxes Owed

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________________.

____ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_X_ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced February 23,2006.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 23, 2006,STILL APPLIES.

_X_ OTHER – See comments below.

SUMMARY

This bill would allow a taxpayer to transfer specified excess tax credits and apply them toward specified taxes administered by the Board of Equalization (BOE).

SUMMARY OF AMENDMENTS

The April 20, 2006, amendments made the following changes:

- Allows excess tax credits to be transferred if the taxpayer employs less than 50 employees at any time during the year, regardless of the amount of time that employee worked for the taxpayer.
- Allows excess credits from the sales and use tax provisions for the Targeted Tax Area (TTA) and the Local Agency Military Base Recovery Area (LAMBRA) to be applied to BOE taxes.
- Allows excess tax credits to be applied to tax liabilities from business attributable within the TTA and LAMBRA.
- Deletes provisions that require revenues to be derived from the imposition of taxes allocated to the General Fund and not a special fund.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	6/15/06
____ N	____ OUA	_X_ PENDING		

The April 20th amendments resolve three of the department's implementation considerations as introduced February 23, 2006. Two new implementation considerations are raised and the remaining implementation considerations are provided below for convenience. In addition, the amendments raise new technical considerations.

The remainder of the department's analysis of the bill as introduced February 23, 2006, still applies.

POSITION

Pending.

ANALYSIS

IMPLEMENTATION CONSIDERATIONS

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

The bill would appear to create an unintended consequence by reducing the amount of time an employee must work for the taxpayer. Taxpayers can hire an employee for one day or have one day in the year with less than 50 employees and be able to apply the excess tax credits. To avoid this result, the author may wish to add language that requires the taxpayer to employ a minimum number of employees for a specified number of days during the tax year. A recapture provision should be added as well to resolve subsequent disqualification issues, such as an employee or taxpayer that terminates employment before the specified number of days has been reached.

The terms "transferred" and "that portion of the excess credits" should be defined. As drafted, it appears that the excess credit can be transferred to any person that is subject to any of the BOE taxes and did not originally generate the credit. The term "transferred" could be interpreted to mean a gift or a sale.

In addition, it is unclear if "that portion of the excess credits" means that the credits can be transferred in the same taxable year as the taxpayer earned the credit, transferred only the first year there is an excess, or transferred every year an excess credit is available.

Below are the concerns restated from the February 23rd analysis:

The employee limitation in the bill could possibly be avoided by large businesses that create smaller subsidiaries. To avoid this result, the author may wish to require that all taxpayers "related" to the entity with the unused credit be aggregated to determine whether the 50-employee limitation is satisfied.

The bill is silent regarding when the transfer of excess credits can be made. Without specific language to clarify when a credit would be available for transfer, problems will arise during processing or an audit.

The bill should identify who can transfer the credit: the taxpayer that earned the credit, an affiliate, or an authorized representative. It is unclear who is authorized to make the transfer even though the credits are on the taxpayer's return.

With pass-through entities, items of income (loss), deductions, credits, and other separately stated items are distributed to each partner or shareholder and taxed at the partner or shareholder level. For all BOE taxes, the business entity is responsible for paying those taxes, not the partner or shareholder. The bill is silent regarding how the application of excess credits for pass-through entities would be handled.

The transfer of credits may be affected by the different due dates for tax returns. BOE has different due dates for the filing of its returns than Franchise Tax Board (FTB). Most taxpayers file their tax return with FTB on a calendar or fiscal year basis. BOE taxpayers file their return on either a monthly, quarterly, calendar, or fiscal year basis depending on their reporting period for the particular tax being credited.

TECHNICAL CONSIDERATIONS

Under Government Code Section 15616.5, the TTA and LAMBRA sales and use tax credit Sections 17053.33, 23633, 17053.45, and 23645 needs to be added.

The bill adds a provision (subparagraph (C), under subdivision (i), paragraph (1), from Sections 17053.33, 23633, 17053.45, and 23645) that requires excess tax credits to be applied to tax liabilities from business attributable within the TTA and LAMBRA. The author may wish to add the same language to the remaining credit provisions in the bill to maintain consistency.

The bill uses the terms "person" to describe a taxpayer that employs less than 50 people. Under the PITL and CTL, a "person" is defined as an individual, a fiduciary, a partnership, a limited liability company, and a corporation. It is unclear if the term "person" is meant to describe an individual. To maintain consistency with defined terms under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), the author may wish to use the term "individual" to describe a natural person or remove the terms "person" and "entity" and only use "taxpayer" to describe a small employer.

The bill also uses the term "issued" to describe credits that can be audited by FTB. Only tax credits that are allocated can be issued to a taxpayer. Credits, such as the Low-Income Housing credit, are allocated a specific amount during the calendar year and include any returned or unused credits from the previous year. The author may wish to replace the term "issued" with "claimed" because credits under this bill are not allocated.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 2502 For Taxable Years Beginning On Or After January 1, 2007 Enactment Assumed After June 30, 2006 ($ in Millions)			
	2006-07	2007-08	2008-09
Credit Transfers	No impact	-$40	-$30

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

Revenue Discussion

There are an estimated $7 billion in unused credits of the types that would qualify for transfer under this bill. The Sales and Use Tax LAMBRA and TTA credits that were added to the bill amounted to approximately $9 million in 2004, which is the most current data available. The $9 million impact represents about 0.1% of the $7 billion total. Therefore, the LAMBRA and TTA credits would increase the cost of this bill by about 0.1% and would have a minimal impact on the revenue estimate presented in the table above. Accordingly, the revenue estimate remains the same as the department's prior analysis of the bill.

LEGISLATIVE STAFF CONTACT

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