**Franchise Tax Board**

# ANALYSIS OF ORIGINAL BILL

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| Author: | Torrico | Analyst: | Nicole Kwon | Bill Number: | AB 2640 |
| Related Bills: | See Legislative History | Telephone: | 845-7800 | Amended Date: | February 24, 2006 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

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| **SUBJECT:** | Quality Jobs Tax Credit |


**SUMMARY**

This bill would create an allocated tax credit for qualified taxpayers that attain certain goals with regard to job creation and retention in California.

This analysis addresses only those provisions of the bill affecting Franchise Tax Board (FTB).


**PURPOSE OF THE BILL**

According to the author’s staff, the purpose of this bill is to use the tax system to encourage the growth and retention of quality jobs in California.

**EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would become effective immediately upon enactment and, by the specific terms of the bill, operative for taxable years beginning on or after January 1, 2006.

**POSITION**

Pending.

**ANALYSIS**

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who 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.

Under the Government Code, state law provides for several types of Economic Development Areas (EDAs): Enterprise Zones, Manufacturing Enhancement Areas, Targeted Tax Areas, and Local Agency Military Base Recovery Areas.

The Revenue and Taxation Code provides an income and franchise tax hiring credit for taxpayers operating in an EDA.

| Board Position: | | | Department Director | Date |
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| ________ S | ________ NA | ________ NP | S. Stanislaus | 4/10/06 |
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## THIS BILL

This bill would provide, for each taxable year beginning on or after January 1, 2006, a credit of an undetermined amount to be awarded to qualified taxpayers via a certificate that meet as yet to be specified and defined criteria related to the retention and growth of quality jobs in California.

The total annual amount of credits to be allowed would be $60 million. The credits would be allocated to California counties as follows: (1) each county would be allowed to award $100,000 in credits; (2) $27.1 million would be allocated among the counties based on population; and (3) $27.1 million would be allocated among the counties based on job losses. The program would be administered by the appropriate administrative agency in each county, under the overall guidance of the Employment Development Department (EDD). Credits would be allowed against a taxpayer's income or franchise tax liability and any excess credit would be carried over for nine years.

This bill requires a qualified taxpayer taking this credit to make available payroll records for inspection and audit by the administrative agency and the EDD.

This bill makes the falsification of an application or fraudulent administration of the credit a misdemeanor.

This bill requires each administrative agency to provide to FTB the names of taxpayers that are awarded the credit.

This bill requires, not withstanding any other provision of law, FTB to provide the necessary tax return information to EDD upon request.

This bill requires the Legislative Analyst's Office to evaluate the utilization of the credit and report to the Legislature its findings by January 1, 2012.

## 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.

In order to easily verify credit eligibility, it is recommended that the bill require taxpayer identification numbers so that FTB can verify the taxpayers that are awarded the credit.

The proposed statute would be placed in the part of the Revenue and Taxation Code (R&TC) administered by FTB; however, the credit is actually administered by EDD. It may be desirable to place the administrative provisions in the Unemployment Insurance Code and the tax credit provisions in the franchise and income tax portions of the R&TC.

The bill directs EDD to audit taxpayers to determine whether the credit is appropriately allowed. For taxation purposes, the word "allowed" means the credit has been reflected on a tax return. The bill needs to distinguish clearly among the credit being granted by an administrative agency and the credit being allowed or "taken" on an income tax return and the state agency responsible for administering those aspects of this credit.

A provision is needed expressly authorizing EDD to furnish credit information to FTB.

The bill directs FTB to provide the necessary tax return information to EDD upon request. This provision of tax return information to EDD may violate the existing IRS and FTB information-sharing agreement.

Criminal income tax statutes pertaining to laws administered by FTB are grouped in Chapter 9, Violations, of Part 10.2 of the R&TC, starting at Section 19701, and are general in their application. To be consistent, it is recommended that this provision be removed from the credit section of the R&TC and put under Violations section of the R&TC.

It is recommended that the bill clearly state which department would be responsible for administering this provision.

TECHNICAL CONSIDERATION

This bill uses the term "department", on page 4, line 5 as a substitute for EDD. In R&TC, department is typically interpreted to mean FTB. In order to avoid confusion, the author's office may want to replace the term "department" with "EDD."

This bill uses the term "credits" when "amounts of credit" is the proper one to use. For example, on page 3, lines 6, 10, 12, and 18, the "credits" should be replaced with "amounts of credit."

## LEGISLATIVE HISTORY

AB 37 (Torrico, 2005/2006) was similar to this bill, except for the total amount of credits allowed and allocated. AB 37 failed passage out of the Assembly Revenue and Taxation Committee.

## OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota,* and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Although each of these states has some kind of economic development program to encourage job growth, those programs are generally targeted to specific distressed areas or disadvantaged employees and are not comparable to the program in this bill.

## FISCAL IMPACT

If this bill were amended to resolve these implementation considerations, implementing this bill would be accomplished during the normal annual update.

**ECONOMIC IMPACT**

Revenue Estimate

The estimated revenue losses from this bill are as follows:

| Estimated Revenue Impact of AB 2640<br>Effective Tax Years BOA 1/1/2006<br>Assumed Enactment Date After 6/30/06<br>(Millions) | | |
|---|---|---|
| **2005-06** | **2006-07** | **2007-08** |
| -$0 | -$45 | -$50 |

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

Revenue Discussion

This bill allocates $60 million annually for the creation of jobs meeting certain criteria. Because the bill contains no restrictions on the amount of credit given to any qualified taxpayer, it is assumed that all of the available tax credits will be awarded. The estimate assumes that 70 percent of the credits awarded will be applied in the first year and the rest carried over to subsequent tax years. The estimates presented reflect fiscal year revenue losses.

**LEGAL IMPACT**

This bill contains provisions that would target certain employment incentives to California.

The U.S. Court of Appeals for the 6th Circuit ruled in *Cuno v. DaimlerChrysler, Inc.* (2004) 386 F. 3d 738 that Ohio's Investment Tax Credit is unconstitutional because it gives improper preferential treatment to companies to locate or expand in Ohio rather than in other states and, therefore, violates the Commerce Clause of the U.S. Constitution. This case is now pending with the U.S. Supreme Court. The Court will issue its decision on this case by the end of June, 2006. Although the outcome of this decision and its affects on the income tax credits of other states, including California, is unknown, targeted tax incentives that are conditioned on activities in California may be subject to constitutional challenge.

**LEGISLATIVE STAFF CONTACT**

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