Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Devore	Analyst:	Deborah Barrett	Bill Number:	AB 689
Related Bills:	See Legislative History	Telephone:	845-4301	Introduced Date:	February 21, 2007
		Attorney:	Daniel Biedler	Sponsor:	

SUBJECT: Employer Hiring Credit/Employers Verify New Employee's Social Security Numbers And Report Annually To FTB/Employment Verification Act of 2007

SUMMARY

This bill would:

- Require employers to report newly hired employee information to the Franchise Tax Board (FTB),
- Provide an income and franchise tax credit for employers that verify the accuracy of the social security numbers (SSN) of new employees, and
- Provide for a penalty to those employers that fail to verify new employee SSNs or submit false or fraudulent information.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to ensure that employers take the necessary steps to verify SSNs used by their employees.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2008, and be operative for taxable years beginning on or after that date.

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.

Board Position:			Department Director	Date
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_______ N	_______ OUA	___X___ PENDING	by Lynette Iwafuchi	

The Internal Revenue Service issues Individual Taxpayer Identification Numbers (ITIN) to individuals who are required to have a United States (U.S.) taxpayer identification number but who do not have, and are not eligible to obtain a Social Security Number (SSN) from the Social Security Administration (SSA). ITINs are issued regardless of immigration status because a person may have U.S. tax return and payment responsibilities under the Internal Revenue Code. Individuals must have a filing requirement and file a valid federal income tax return to receive an ITIN, unless they meet an exception. ITINs are for federal tax reporting only and are not intended to serve any other purpose. An ITIN does not authorize work in the U.S. or provide eligibility for Social Security benefits or the Earned Income Tax Credit.

Under current state law, the Employment Development Department (EDD) is responsible for the administration of state employment tax, including the personal income tax withholding. Additionally, EDD administers the provisions of the New Hire Registry, where employers in California are required to report newly hired employees to EDD within 20 days of the first day of work.

PROGRAM BACKGROUND

The SSA offers two Internet verification options to verify an employee's name and SSN. Option one allows an employer to verify up to 10 names and SSNs online and receive immediate results. Option two allows the employer to send batch files of up to 250,000 names and SSNs to be verified against SSA records. The batch process results are usually received within one to two business days. SSA verification confirms that the name and SSN submitted match the name and SSN in SSA records. Verification of the SSN and name match does not prove that the person using the SSN and name is the correct person for whom the SSN was issued.

Currently, when multiple income tax returns are received that have the same SSN, FTB will assign the duplicate accounts a Taxpayer Identification Number in order to process their returns. FTB has in excess of 3 million accounts with Taxpayer Identification Numbers.

THIS BILL

This bill would require employers to verify the SSN of new employees within 30 days of hiring that employee by utilizing the SSA Verification Service. Employers would be required by January 31 of each year to provide written documentation to FTB of the name and SSN for each individual employed in the previous year. Employers would be subject to a $1,000 penalty as follows:

- for each employee for whom the employer fails to submit verified documentation or
- for each false or fraudulent verification document submitted.

This bill would allow a $100 income tax credit to the employer for each new employee for whom the employer provides FTB with a valid SSN, as verified by the SSA Verification Service. If the tax credit allowed under this bill exceeds the tax for individuals or sole proprietors or the net tax for other business entities, the excess may be carried over to reduce the tax or net tax in the following or succeeding years until the credit is exhausted.

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.

Generally, bills that contain a tax levy are operative on January 1 of the year enacted. This bill does not contain tax levy language, so it would be effective on January 1 following the year of enactment. If it is the intent of the author that the bill be a tax levy, it is recommended that the appropriate language be added.

Employers are currently required to report new hire information to EDD within 20 days of the employee's first day of work. To avoid adding a new report requirement on employers, the author may want to consider adding the report of a new employee's valid SSN to the existing EDD reporting requirements with provision for EDD to forward the report to FTB.

The annual report identified in this bill would require the documented name and SSN of all employees, although only newly hired employees would be required to be verified. The author may wish to amend the language to clarify whether the credit or penalty are applicable for all employees or only the newly hired.

The penalty would lack any exception in the event of an inadvertent omission of data. The author may want to provide an exception for reasonable cause to specify circumstances where relief from the penalty would be appropriate.

The bill could be read to require employers to verify the SSNs of out of state employees and claim the credit for those employees. The author may want to limit the applicability of this bill to those employees employed or performing services in California. Alternatively, adding a requirement based on employment in California may subject the language to constitutional challenge under the Commerce Clause of the United States Constitution.

This bill would allow a credit for newly hired employees without a requiring employment for any specific length of time. Without a requirement for length of employment, the bill could be interpreted to allow the credit where an employee works just one day.

FISCAL IMPACT

Implementing this bill would require changes to existing tax forms and electronic applications to incorporate a new credit and assess a new penalty. In addition, the new SSN reporting requirement would necessitate the development of new forms and instructions.

To either impose the penalty or allow the credit, FTB would need to develop a new program to capture and match the employee information that would be submitted separately from the filed tax return.

The additional costs for these items will be identified and an appropriation requested as the bill moves through the legislative process and the implementation concerns are resolved.

ECONOMIC IMPACT

Based on data and assumptions discussed below, the PIT and Corporation Tax revenue impact from this bill would be as follows:

Revenue Analysis for AB 689 – As Introduced 2/21/07 Effective and Operative January 1, 2008 Enactment Assumed After June 30, 2007 ($ in Millions)			
Fiscal Year	2007-08	2008-09	2009-2010
New Employee SSN Verification Credit for Employers	-$215	-$840	-$890
Penalty Revenue	0	0	+$135
Net Revenue Loss	-$215	-$840	-$755

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

Revenue Discussion

Based on the U.S. Census Bureau's 2005 American Community Survey, there were a total of 12.3 million private wage and salary workers in the state of California (does not include undocumented labor). Using the Bureau of Labor Statistics voluntary turnover rate of 23.4% yields roughly 2.9 million potentially SSN-verified new California employees per year. Under this proposal, California taxpayers would also be able to claim a $100 credit per SSN-verified new hire for employees residing outside of California. This estimate assumes there will be three qualified new employees out-of-state for each qualified in-state new hire. Thus, the projected total number of qualified new employees in 2007 and beyond would be 11.6 million per year (2.9M + 8.7M), equal to roughly $1.2 billion in estimated total credits generated annually. It is assumed 60% of all credits generated ($0.3B resident employees plus $0.9B out-of-state employees) are applied in a given year, resulting in a potential revenue impact of around $720 million per year. Revenues reported in the table above have been adjusted to represent fiscal year impacts.

The potential revenue generated from the imposition of penalties authorized by this bill depends on the population of employees whose SSN cannot be verified and the percentage of such employees that are reported by employers. No penalties would be generated by employees who are paid off the books. Also, FTB would have difficulty enforcing penalties when an employer submits (to both FTB and EDD) a name and social security number that match, even though neither belongs to the person employed. Assuming that, despite these limitations, 5% of the 12.3 million employees described above are found to be improperly documented, potential annual penalties would be about $675 million (12.3 million x 5% x ($1000 fine + $100 lost credit). The estimates presented above assume that FTB would only have audit capacity to catch 20% of the employees without proper documentation ($675/5 = $135 million). As a result of the time lags inherent in the audit process, fines levied on the 2008 tax year are assumed to be collected during the 2009/2010 fiscal year.

POLICY CONSIDERATIONS

This bill allows an unlimited carryover period. Consequently, the department would be required to retain the credit on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation; experience shows credits are typically exhausted within eight years of being earned.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would provide a credit to an employer for information already obtained by FTB from another source. FTB currently obtains records from the IRS that includes an indicator for SSNs and names that have been verified through the SSA.

LEGISLATIVE STAFF CONTACT

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