

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Swanson Analyst: Angela Raygoza Bill Number: AB 1973
Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: February 17, 2010
Attorney: Patrick Kusiak Sponsor:

SUBJECT: Employer Hiring Credit/Ex-Offender

SUMMARY

This bill would provide a tax credit to a business that employs ex-offenders, as specified.

PURPOSE OF THE BILL

According to the author’s office, the purpose of this bill is to encourage taxpayers to employ ex-offenders to provide them with an opportunity to become productive citizens.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2010.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal law allows employers who hire employees from a “targeted group,” as defined, to elect to claim a work opportunity credit.1 The credit is equal to 40 percent of the qualified first-year wages for that year. The amount of the qualified first-year wages that may be taken into account with respect to any individual shall not exceed \$6,000 per year (\$12,000 per year in the case of any individual who is a qualified veteran).

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.

1 Internal Revenue Code (IRC) section 51 defines the Work Opportunity Credit

Table with Board Position (S, NA, NP, SA, O, NAR, N, OUA, X PENDING), Department Director (Selvi Stanislaus), and Date (04/06/10).

Under the Government Code, state law provides for several types of geographically targeted economic development areas (G-TEDAs): Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs).

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within a G-TEDA. These incentives include a hiring credit, sales or use tax credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within G-TEDAs and a credit for employees working in an EZ.

A business located in a G-TEDA is eligible for a hiring credit equal to a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as a G-TEDA and meet certain other criteria. At least 90 percent of the qualified employee's work must be directly related to a trade or business located in the G-TEDA and at least 50 percent of the employee's services must be performed inside the G-TEDA.

The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current minimum hourly wage (under special circumstances for the Long Beach EZ, the maximum is 202 percent of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Current law allows a credit for taxable years beginning on or after January 1, 2009, for a qualified employer in the amount of \$3,000 for each qualified full-time employee hired in the taxable year, determined on an annual full-time equivalent basis. The credit is allocated by the Franchise Tax Board and has a maximum cap of \$400 million for all taxable years. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed as of that date. Any credits not used in the taxable year may be carried forward up to eight years.

### THIS BILL

For each taxable year beginning on or after January 1, 2010, this bill would provide a tax credit to the taxpayer for the salary paid to each qualified employee. The credit would be equal to 20 percent of the gross salary, not to exceed \$5,000 per employee for the first and second year of employment.

Under this bill, the credit would be allowed for the first year of employment if the qualified employee is employed by the taxpayer for 12 consecutive months from the date of employment. For the second year of employment, the tax credit would be allowed if employed by the taxpayer for 24 consecutive months from the date of employment.

This bill would define “qualified employee” as an individual who is an ex-offender employed by the taxpayer in a part-time or full-time position. Excluded from the definition of “qualified employee” would be an ex-offender who is required to register as a sex offender,<sup>2</sup> or the equivalent in another state or territory, under military law, or under federal law, or was convicted of a serious or violent felony.

This bill specifies that any other credit or deduction for the same salaries paid or incurred by the taxpayer would be reduced by the amount of credit.

Under this bill, unused credits can be carried over into future years until 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.

This bill uses terms or phrases that are undefined including “gross salary,” “ex-offender,” “part-time position,” “full-time position,” and “serious or violent felony.” The absence of definitions to clarify these terms or phrases could lead to disputes with taxpayers and would complicate the administration of this credit.

This bill would provide a credit based on a percentage of the gross salary for each qualified employee. The term “salary” could be limited to non-hourly wages. If this is not the author’s intent, it is recommended the bill be amended to use the term “wages” to encompass hourly and salary employees.

It is unclear if the \$5,000 limitation language refers to the maximum salary paid that would qualify for the credit or the maximum amount of credit for each qualified employee. The lack of clarification could cause disputes between taxpayers and the department. This bill requires that a qualified employee be employed by the taxpayer for 12 consecutive months. As written, it appears current employees could qualify for this credit. For example, a taxpayer who employs a “qualified employee” for at least 12 consecutive months as of January 1, 2010, could be eligible to claim this credit. If this is not the author’s intent, it is recommended the bill be amended to clarify that the credit would apply to qualified employees hired on or after January 1, 2010. Additionally, it is unclear if a qualified employee hired in 2010 and employed for 12 consecutive months would qualify the taxpayer for a credit in 2010 or 2011. If this is not the author’s intent, it is recommended the bill be amended to specify when the taxpayer would be eligible to claim the credit.

This bill fails to specify a timeframe that an individual would be considered an “ex-offender.” For example, without a timeframe, an employee that was convicted of a felony ten years ago could qualify the taxpayer for this credit. The author may consider further defining “qualified employee” by adding a timeframe for which the criteria would apply. In addition, it is unclear what constitutes an ex-offender. For example, an individual could have a traffic violation and be considered an ex-offender. If this is not the author’s intent, it is recommended the bill be amended to clarify the requirements of an ex-offender to ease administration of this bill.

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<sup>2</sup> Penal Code section 290 is known as the “Sex Offender Registration Act.”

This bill would provide a credit to employers that employ ex-offenders. It is unclear in the bill, who would certify whether that the employees are ex-offenders. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies, such as the Department of Justice, that possess the relevant expertise.

### TECHNICAL CONSIDERATIONS

The term "net tax" is used to define the tax for the Personal Income Tax Law. "Net tax" was used to define the tax in the Corporate Tax Law (CTL). The correct term to use for the CTL section of this bill is "tax." On page 3, lines 20 and 21, strikeout "net tax" and insert "tax."

The term "described in" as used in paragraph (1) subdivision (a) is unclear. The correct term to use is "specified in." On page 1, line 5, strikeout "described in" and insert "specified in."

### **LEGISLATIVE HISTORY**

AB 340 (Knight, 2009/2010) would have provided a tax credit for a qualified employer in an amount equal to 5 percent of the wages of all qualified employees employed by the qualified employer during the taxable year. This bill failed passage out of the Assembly Revenue and Taxation Committee.

AB 1139 (Perez, 2009/2010) would have modified the definition of ex-offender for purposes of the existing EZ hiring credit. This bill failed passage out of the Assembly Revenue and Taxation Committee.

AB 2617 (Tran, 2009/2010) would provide a tax credit to a qualified taxpayer for qualified wages in an amount equal to 15 percent of the wages paid or incurred during the taxable year. This bill is currently in the Assembly Revenue and Taxation Committee.

AB 2630 (Emmerson, et al., 2009/2010) would provide a tax credit of \$3,000 for each net increase in full-time employees hired during the taxable year by a qualified employer until the state employment rate is 5.5 percent or lower. This bill is currently in the Assembly Revenue and Taxation Committee.

SB 508 (Dutton 2009/2010), SBX6 11 (Dutton, 2009/2010), and SBX8 59 (Dutton, 2009/2010) are identical. These bills would have provided a tax credit for the first \$6,000 of wages paid or incurred to an individual documented by the Employee Development Department. SB 508 failed passage out of the Senate Revenue and Taxation Committee by the constitutional deadline; SBX6 11 (Dutton, 2009/2010) is located in the Senate Rules Committee; SBX8 59 failed passage out of the Senate Revenue and Taxation Committee without further action.

SB 612 (Runner, 2009/2010) would have provided a tax credit of \$500 per month for each qualified employee employed by a taxpayer. This bill failed passage out of the Senate Revenue and Taxation Committee.

ABX3 15 (Stats. 2009, Ch. 10) and SBX3 15 (Stats. 2009, Ch. 17) provides for a tax credit of \$3,000 for each net job increase.

**OTHER STATES' INFORMATION**

*Florida* allows businesses located in an EZ a credit based on wages paid to new employees. Other wage-based credits are offered to businesses that are located in high crime areas or in rural areas.

*New York* allows a wage credit to a business that hires a full time employee (either one in targeted group or not) for a newly created job in an Empire Zone.

*Illinois* allows a job tax credit for taxpayers conducting a trade or business in an EZ or a High Impact Business. The credit is \$500 for each eligible employee hired to work in the zone during the tax year. It is available for eligible employees hired on or after January 1, 1986.

*Massachusetts* allows a Full Employment credit to employers who participate in the Full Employment Program and continue to employ a participant for at least one full month. The taxpayer may claim a credit of \$100 per month of eligible employment per participant, up to \$1,200 per participant.

*Michigan* and *Minnesota* do not offer wage credits.

**FISCAL IMPACT**

This bill would require a calculation for the credit that would require a new form or worksheet to be developed. As a result, this bill would impact the department's printing, processing, and storage costs for tax returns, instructions, and publications. These changes could be incorporated into the department's annual changes, and as such, the costs would be minor.

**ECONOMIC IMPACT**

Revenue Estimate

Estimated Revenue Impact of AB 1973 Operative For Taxable Years Beginning On or After January 1, 2010 Enactment Assumed After June 30, 2010 (\$ in Millions)		
2010-11	2011-12	2012-13
-\$160	-\$110	-\$100

## **POLICY CONCERNS**

This bill fails to specify if the taxpayer could claim multiple benefits. It appears that a taxpayer could claim the credit proposed by this bill and the newly enacted Job Tax Credit (Calderon, Stats. 2010, Third Extraordinary Session, 2009, Ch. 17). Both credits provide a benefit for different types of expenses. This bill applies to salaries paid to a qualified employee; the Job Tax Credit applies to an increase in hours to achieve a full-time equivalent employee. Generally, a credit is allowed in lieu of any deduction or credit already allowable for the same item of expense in order to eliminate multiple tax benefits.

This bill does not restrict the credit to employees who are employed within California (and are thus themselves subject to California tax on their earnings).

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

## **LEGISLATIVE STAFF CONTACT**

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