Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Knight | Analyst: Angela Raygoza | Bill Number: AB 340

Related Bills: See Prior Analysis | Telephone: 845-7814 | Amended Date: May 12, 2009

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Employer Hiring Credit

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

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

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended __________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO __________________.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED March 24, 2009, STILL APPLIES.

X OTHER – See comments below.

SUMMARY

This bill would provide a tax credit for each qualified employee employed by a qualified employer, as specified.

SUMMARY OF AMENDMENTS

The May 12, 2009, amendments would do the following:

- Correct referencing to the Revenue and Taxation Code (R&TC) sections;
- Provide a cease operative date of taxable years beginning on or after January 1, 2013;
- Require an employee to complete a majority or a minimum of 50 percent of work in a specified county where the employee's wage is at a specified level in excess of the average wage in that county for the qualified employer to receive a $5,000 tax credit;
- Define "average wage" and "qualified wages;"
- Modify the definition of "headquarters," "qualified employee," and "qualified employer;"
- Add language that would disallow multiple tax benefits; and
- Add a repeal date of December 1, 2013.

Board Position:			Asst. Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Patrice Gau Johnson	09/18/09
____ N	____ OUA	X PENDING		

As a result of the May 12, 2009, amendments the "Effective/Operative Date," "This Bill," "Implementation Consideration," "Technical Considerations, "Economic Impact," and "Legal Impact" discussions have been revised. The amendments resolve one of the legal impact concerns that would deny the same incentive if nonresidents are employed and all of the policy concerns in the department's analysis dated March 24, 2009. The fiscal impact discussion has been repeated below for convenience. The remainder of the March 24, 2009, analysis still applies.

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, 2009, and before January 1, 2013.

ANALYSIS

<u>THIS BILL</u>

For taxable years beginning on or after January 1, 2009, and before January 1, 2013, this bill would provide a qualified employer with a tax credit of: (1) $3,000 for each qualified employee, or (2) $5,000 if the wage paid to a qualified employee is 200 percent or more than the average wage in the county in which the qualified employee completes a majority, or at least 50 percent, of his or her work.

This bill would define the following:

- "Average Wage" means the wage average of each county, as determined by the Employment Development Department.
- "Headquarters" means the principal administrative office in California of a qualified employer that employs 30 or more qualified employees at that office.
- "Qualified employee" means an employee who was paid qualified wages by the qualified employer for services rendered for no less than an average of 35 hours per week.
- "Qualified employer" means a taxpayer that is a person engaged in a trade or business within California that has either established a headquarters within California or relocated a headquarters to California, and, as of the last day of the preceding taxable year, employed a total of 30 or more employees.
- "Qualified job" means employment located at the qualified employer's headquarters that is full-time employment, as defined by the Unemployment Insurance Code, and that pays wages that equal or exceed the average wage in the county in which the headquarters are located.
- "Qualified wages" means the amount of wages subject to the Unemployment Insurance Code.[1]

---

[1] Beginning with Section 13000 of the Unemployment Insurance Code, this section requires withholding state income taxes on wages paid to a resident employee for services performed either within or without this state, or to a nonresident employee for services performed in this state.

In addition, this bill would provide rules for aggregating affiliated employers for purposes of determining an employee tax credit. FTB would be allowed to prescribe appropriate regulations, including any regulations necessary to prevent the avoidance of the application of this bill through split-ups, shell corporations, partnerships, tiered ownership structures, or otherwise.

This bill would require the credit to be available to a qualified employer for the first taxable year and succeeding year where the qualified employer's headquarters are established within, or relocated to, California.

This bill would allow unused credits to be carried over for 11 years or until exhausted.

This bill would specify that the credit allowed by this bill would be in lieu of any deduction or credit allowed for the same qualified wages.

This credit would be repealed on December 1, 2013.

IMPLEMENTATION CONSIDERATIONS

The following implementation concerns were identified in the department's analysis dated March 24, 2009, and are unresolved:

Because this bill provides for a tax credit for a period for which credits are limited to 50 percent of tax liability, the credit for that taxable year would be subject to the 50 percent limitation under current law.[2] If this is not the author's intent, it is recommended the bill be amended to exclude the credit from the 50 percent limitation.

The May 12, 2009, amendments raise additional implementation concerns, as follows:

This bill would require a "qualified employee" to render no less than an average of 35 hours a week. The bill fails to require that the employee be employed for a specific period of time. Otherwise, one can hire an employee for one week and take the credit 52 times for the same position. If this is not the author's intent, it is recommended the bill be amended to require the employee to be employed for a specific period of time to prevent employee churning.[3]

This bill would require the qualified employer to have a total of 30 or more employees. The bill fails to specify whether those 30 employees can be within or out of California, which means the qualified employer with ten employees can aggregate all other subs, even those located out of California to meet the minimum 30 employee requirement. If this is not the author's intent, it is recommended the bill be amended to clarify the 30 employees be located in California.

---

[2] Revenue and Taxation Code section 17039.2 and 23036.2 require all business credits to be limited to 50% for two taxable years and only if the business income exceeds $500,000. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed.

[3] Churning occurs when employers manipulate turnover rates to maximize their tax credit by hiring several workers for short periods of time. (Joint Committee Report of March 1997)

TECHNICAL CONSIDERATIONS

The following technical consideration was identified in the department's analysis dated March 24, 2009, and is unresolved:

This bill provides rules for aggregating affiliated corporate employers under the personal income tax (PIT) section. To ease administration of this bill and prevent confusion with taxpayers, it is recommended that the bill be amended to provide PIT rules for affiliating employers in the PIT section.

The May 12, 2009, amendments raise additional technical considerations as follows:

The term "qualified job" was removed when the definition of "qualified employee" was revised. Because the term "qualified job" is no longer described in the bill, it is recommended that the term "qualified job" be removed to avoid confusion.

Because "at least 50 percent" and "completes a majority" are synonymous, it is recommended that the author amend the bill to use either one of the phrases to avoid confusion with taxpayers.

On page 2, line 18, the term "administrative" is misspelled.

On page 4, line 10, the term "average" should be deleted from the sentence to be consistent with the PIT section.

FISCAL IMPACT

If the implementation and technical considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 340 As Amended on May 12, 2009 For Taxable Years Beginning On or After January 1, 2009 Enactment Assumed After June 30, 2009 ($ in Millions)			
Fiscal Year	2009-10	2010-11	2011-12
Revenue Loss	-$7.4	-$15	-$20

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

Revenue Discussion

The revenue impact of the bill as amended May 12, 2009, would depend on the tax benefit associated with reporting the proposed credit instead of a corresponding wage expense deduction, the number of qualified employees working for qualified employers during 2008 or later, and the amount of credits that would be applied to reduce tax liabilities each year.

The estimate was developed in the following steps:

- Step 1: Estimated ten firms that would relocate their headquarters to California each year: A recent business study published in September, 2008, indicates approximately 20 firms relocate into California each year. This was reduced by 50 percent to reflect current economic conditions.
- Step 2: Estimated 1,900 start-up firms with 30 or more employees during first two years of commencing business in California:
  The Small Business Administration report issued in 2008 indicated that approximately 75,000 start-up firms began conducting business in California. Less than 3 percent of these businesses employ approximately 30 or more employees. It is estimated approximately 1,900 (75,000 firms x <3% firms with 30 or more employees) qualified employers would be established each year.
- Step 3: Estimated 120 qualified employees for firms relocating to California and 30 qualified employees for firms starting-up in California:
  Based on the business study published in September, 2008, it was assumed that 120 qualified employees for each firm relocating to California and a minimum of 30 employees per start-up firm would be needed to qualify for the credit.
- Step 4: Determined approximately 43,500 qualified employees in qualified jobs each year: It is estimated that approximately 1,200 employees would be working for qualified employers that would relocate to California (10 firms x 120 employees) and approximately 57,000 employees for qualified employers starting-up (1,900 firms x 30 employees) – a total of 58,200 employees (1,200 relocated employees + 57,000 established employees). It is assumed that 75 percent of the 58,200 employees would be in a qualified job. This produces approximately 43,500 qualified employees in qualified jobs (58,200 x 75%).
- Step 5: Assumed 40 percent of qualified employees earn average pay in a county and 60 percent earn double the county average.

  The estimate assumes that an employee that would at any headquarters and would be determined to have central administrative responsibilities could qualify for the proposed credit. In other words, if a start-up firm has just one principal business location and such location is deemed to include central administrative responsibility, any qualified employee working at that location would generate a credit for the qualified employer (whether or not their individual job duties were administrative by nature, e.g., a manufacturing job). Also, it is assumed that the requirement for an employee to work an average of 35 hours per week is assumed to mean ‘yearly’ average. Otherwise, one can hire an employee for one week only and take the credit 52 times for the same position. This estimate assumes no abusive churning of employment.

- Step 6: Determined the tax benefit of the proposed credit in place of a wage expense deduction or other hiring credit on behalf of the same qualifying employee.

  Based on the Employment Development Department (EDD) labor market data the average pay for administrative, managerial and clerical workers, is approximately $32,420. Assuming a 6 percent marginal tax rate, the tax benefit of deducting such wages would be $1,945 ($32,420 x 6%). The tax benefit of reporting the credit instead of a deduction is estimated at $1,055 ($3,000 tax benefit of claiming the credit - $1,945 tax benefit of deducting wages). For employees earning double the county average, the estimated average annual salaries used were $79,380. The benefit of reporting a credit instead of a deduction for the higher-paid employee group was estimated to be $237 [($79,380 employees earning double the county average x 6% tax rate ≈ $4,763) – $5,000 proposed credit].

  Step 7: Computed total credits generated in 2009: $19.6 million

  Given the above assumptions and projections, 17,380 qualified employees (43,500 employees x 40% earning average pay) would generate a tax benefit for qualified employers of $18.3 million (17,380 x $1,055). Another 26,069 qualified employees (43,500 x 60% earning double the average pay) would generate an incremental tax benefit of $237 for qualified employers, totaling $6.2 million (26,069 x $237). The sum of credits generated by each of these two groups of qualified employees is $24.5 million ($18.3 million + $6.2 million).

  An otherwise qualified employer that establishes or relocates into an enterprise zone or other economic development area in California could not claim the proposed credit in place of a more tax advantageous alternative hiring credit. A reduction factor of 20 percent is assumed to account for this sub-group of firms, resulting in an estimated single-year impact of approximately $19.6 million ($24.5 million sum of credits generated x 80%).

- Step 8: Increased annual tax impact to reflect the provision requiring at least 30 employees in the preceding taxable year: $20 million

  As amended on March 24, 2009, the proposed credit would be available in the first taxable year and the succeeding taxable year in which a qualified employer has either established within or relocated to a headquarters in California. Starting with the 2009 taxable year, any firm starting up or relocating in California during 2008 and after would qualify for the proposed credits in their initial year of commencement and the succeeding year.

  This bill requires that an employer must have had 30 employees in the preceding taxable year to be eligible for the proposed credit. This estimate assumes a 2008 start-up firm would only be eligible for the credit in their second year after establishing operations in California, at which point they would meet the 30 employees in preceding taxable year requirement. Conversely, a 2008 relocating firm (assumed to have 30 employees elsewhere prior to moving into California) would be entitled to claim two years of credits starting in tax year 2009.

To account for this observation, a second year vintage adjustment of approximately 102.2 percent is made to reflect qualified employees of firms that relocated to California starting in 2008. This annual gross-up factor is based on the proportionate ratio of employees in relocating firms - 1,200, relative to total qualifying employees - 58,200, or approximately 2 percent (1,200 ÷ 58,200 ≈ 0.02). Thus, in any given taxable year starting with the 2009 tax year, total proposed tax benefits are estimated at approximately $20 million ($19.6 million x 1.02).

- Step 9: Determined rate of taxpayer awareness and calculated applied credits starting with taxable year 2009: $5 million

  This analysis assumes that in the first operative taxable year, 2009, just 70 percent of potential credits would be reported. Of this reported amount, it is assumed that qualified employers would be able to apply one-third of the amount of tax benefits generated to reduce taxes owed. Of the $20 million in tax benefits, approximately $5 million would be applied to reduce taxes otherwise paid ($20 million x 70% awareness x 33% applied).

  Taxpayer awareness is assumed to increase by 10 percent in the second year to 80 percent, and 5 percent each year thereafter. This analysis assumes no more than 95 percent of potential credits generated are ever reported. Taxpayers that do not report a credit in the initial year are assumed to amend the prior year's return in successive years. Unused carryover credits are assumed to be applied ratably over the next two years.

- Step 10: Converted taxable year estimates into fiscal year cash flow estimates in the above table.

  The $7.4 million of revenue losses consists of $4.1 million reduction of 2009 taxes owed and another $3.3 million in reduced estimated tax payments for 2010 that would otherwise have been paid by June 30, 2010.

LEGAL IMPACT

This credit would be limited to an employer whose principal central administrative office would be located in California. Although the principal office could be the location of where the operation is managed, not where the work is performed, restrictions based on the location of a business could be subject to challenge as unconstitutional discrimination in favor of local commerce in violation of the Commerce Clause of the United States Constitution.

LEGISLATIVE STAFF CONTACT

Legislative Analyst	Revenue Director	Assistant Legislative Director
Angela Raygoza	Jay Chamberlain	Patrice Gau-Johnson
(916) 845-7814	(916) 845-3375	(916) 845-5521
angela.raygoza@ftb.ca.gov	jay.chamberlain@ftb.ca.gov	patrice.gau-johnson@ftb.ca.gov