

**SUMMARY ANALYSIS OF AMENDED BILL**

Author: Yee Analyst: Gail Hall Bill Number: SB 1391  
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: August 2, 2010  
 Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Employer Tax Credit/Reporting Information/New Credits Chaptered After January 1, 2011, Would Be Recaptured If Taxpayer Has Net Decrease In Full-Time Employees

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the X previous analysis of bill as introduced/amended May 19, 2010.

X FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED X May 19, 2010, STILL APPLIES.

X OTHER – See comments below.

**SUMMARY**

This bill would disallow certain business tax incentives that reduce tax if the taxpayer fails to achieve specified employment requirements.

**SUMMARY OF AMENDMENTS**

The August 2, 2010, amendments made the following changes to the bill:

- Expanded the bill to recapture or disallow business tax incentives and provided a definition for “business tax incentive.”
- Removed the requirement for a taxpayer to provide the number of full-time, part-time, and temporary jobs created by the tax credit.
- Added that only employees in the state would be included in the calculation of full-time equivalent employee.
- Added a small business exception.
- Added five additional implementation considerations
- Added a technical consideration.

Board Position:	Legislative Director	Date
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Except for the “This Bill,” Implementation Considerations,” and “Technical Considerations” discussions, the remainder of the department’s analysis of the bill as amended May 19, 2010, still applies. The “Fiscal Impact” and “Economic Impact” discussions have been provided for convenience.

## **EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately and operative for taxable years beginning on or after January 1, 2011, and specifically operative for business tax incentives allowed by acts that take effect on or after January 1, 2011. The calculation of the net decrease in full-time equivalent employees would be determined on and after January 1, 2014.

## **POSITION**

Pending.

## **ANALYSIS**

### THIS BILL

This bill would require a taxpayer doing business in the state under Personal Income Tax Law (PITL) or Corporation Tax Law (CTL) that claims a business tax incentive to submit to the Franchise Tax Board (FTB) on a timely filed original return the following information in the form and manner as required by forms and instructions prescribed by the FTB:

- The number of full-time, part-time, and temporary employees, as defined, employed by the taxpayer in the state for the current and preceding taxable years.

This bill would provide that for any business tax incentive that takes effect on or after January 1, 2011, the business tax incentive would be disallowed and any business tax incentive previously allowed would be recaptured and the taxpayer would be liable for any tax from disallowed business tax incentives on previous tax returns if the taxpayer has a net decrease in the number of full-time equivalent employees in the state according to the information submitted to the FTB.

“Business tax incentive” would mean a credit, deduction, exclusion, exemption, or any other tax benefit provided by the state that is added to PITL or CTL on or after January 1, 2011, and enacted with the principal purpose of creating new jobs in the state, and allowed to taxpayers engaged in or carrying on any trade, business, profession, vocation, or calling, or commercial activity in the state. This includes activities in the state that benefit an affiliated entity of the taxpayer, with respect to the income attributable to the taxpayer’s trade, business, profession, vocation or calling, or commercial activity.

The net decrease in full-time equivalent employees in the state would be determined on and after January 1, 2014, on a full-time equivalent basis as follows:

- The total number of full-time equivalent employees in the state employed in the three preceding taxable years by the taxpayer and by any trade or business acquired by the taxpayer during the current taxable year, divided by three, minus
- The total number of full-time equivalent employees in the state employed in the current taxable year by the taxpayer and by any trade or business acquired during the current taxable year.

This bill would define “full-time equivalent” to mean either of the following:

- In the case of a full-time employee paid hourly qualified wages, the total number of hours worked for the taxpayer by the employee (not to exceed 2,000 hours per employee) divided by 2,000.
- In the case of a salaried full-time employee, the total number of weeks worked for the taxpayer by the employee divided by 52.

In addition, the bill would provide that all employees of the trades or businesses that are treated as related under either sections 267, 318, or 707 of the Internal Revenue Code would be treated as employed by a single taxpayer.

Section 19521 of the Revenue and Taxation Code relating to the computation of interest, would apply to any tax from disallowed business tax incentives.

This bill would provide the following definitions:

- “Full-time employee” would mean an employee who works an average of 35 hours in a week, calculated monthly.
- “Part-time employee” would mean an employee who works less than an average of 35 hours in a week, calculated monthly.
- “Temporary employee” would mean an employee who works less than 120 days per year.

Under PITL, this bill would not apply to a taxpayer with 50 or fewer employees and with net business income of less than \$500,000 for the taxable year. “Business income” would mean 1) income from a trade or business, whether conducted by the taxpayer or a passthrough entity, owned directly or indirectly by the taxpayer. “Passthrough entity” would mean a partnership or S corporation, 2) income from rental activity, and 3) income attributable to a farming business.

Under CTL, this bill would not apply to a taxpayer with 50 or fewer employees and with income subject to tax of less than \$500,000.

This bill would not limit the authority of the FTB to audit the information provided by the taxpayer. In addition, this bill would waive review by the Office of Administrative Law any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB relating to the information required to be submitted by a taxpayer relating to full-time, part-time, and temporary employees.

### IMPLEMENTATION CONSIDERATIONS

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

1. In order for the department to administer this bill, any business tax incentive that is enacted and would take effect on or after January 1, 2011, would need to include legislative intent language that specifically provides that the purpose of the business tax incentive is to create jobs. If the business tax incentive bill is silent, it would be difficult for the department to determine if any newly enacted law is a business tax incentive with the principal purpose of creating jobs. Even if a determination could be made by the department, it would be doubtful if the determination would be sustained by the courts because the actual "principal purpose of creating jobs" would not be specifically included in the law.
2. It is unclear what is meant by the definition of a "business tax incentive" that includes the sentence, "This includes activities in the state that benefit an affiliated entity of the taxpayer, with respect to the income attributable to the taxpayer's trade, business, profession, vacation or calling, or commercial activity." It is recommended that the author clarify the intent of this sentence.
3. This bill lacks specific rules on how to calculate the total number of full-time equivalent employees when a taxpayer disposes of a trade or business. Clarifying these rules would increase compliance and decrease disputes between the department and taxpayers.
4. The August 2, 2010, amendments removed the provisions that would have provided specific details on how to compute the interest and calculate the amount of business tax incentives reported on previous returns that would be recaptured if the taxpayer has a net decrease in the number of full-time equivalent employees. It is recommended the author amend the bill and include specific details on how to compute the interest and calculate the amount of business tax incentive recapture. Without specific rules, the department would be unable to administer the recapture provisions.
5. Under CTL, if a business credit subject to the provisions of this bill is assigned to another member of the combined group, it is unclear if both the assignor and assignee would need to show no decrease in the number of full-time equivalent employees in order to claim the business tax incentive. It is recommended that the author clarify this point.

## TECHNICAL CONSIDERATIONS

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

1. The definition of "business tax incentive" would mean a credit, deduction, exclusion, exemption, or any other tax benefit added to PITL or CTL on or after January 1, 2011, which is inconsistent with provisions of the bill on page 2, line 18, and page 5, line 13 that provide that business tax incentives that take effect on or after January 1, 2011, could be disallowed.
2. On page 4, line 1, and page 6, line 32, it appears subdivisions (d) and (e) were incorrectly referenced.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

This bill does not have any revenue effect because it does not alter any provisions of current tax law.

This bill would place constraints on potential future changes to tax law. The effects of this bill would be incorporated into the revenue estimates for future proposals to add business tax incentives; but cannot be estimated now because we do not know what those future proposals will be.

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