Franchise Tax Board

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 17 and 20, 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

_X_ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended August 2, 2010.

____ 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 ____________________.

____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ________________________ 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 17, 2010, amendments made the following changes to the bill:

- Resolved implementation considerations 2 through 5 discussed in the department's analysis of the bill as amended August 2, 2010. (See Appendix A).
- Resolved all the technical considerations discussed in the department's analysis of the bill as amended August 2, 2010. (See Appendix A).
- Revised the definition of "business tax incentive."
- Revised the calculation of the net decrease in full-time equivalent employees.
- Revised the small business exception.
- Added a penalty exclusion.
- Removed language that the bill would take effect immediately as a tax levy.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	8/26/10
____ N	____ OUA	_X_ PENDING		

The August 20, 2010, amendments added to the Corporation Tax Law (CTL) that employees in the state who are employed in any trade or business sold by a taxpayer would be excluded in the determination of the net decrease in full-time equivalent employees.

Except for the “Effective/Operative Date” and “This Bill” discussions, the remainder of the department’s analysis of the bill as amended August 2, 2010, still applies.

POSITION

Pending.

EFFECTIVE/OPERATIVE DATE

If this bill is signed by September 30, 2010, the effective date of the law would be January 1, 2011, and it would be generally operative for taxable years beginning on or after January 1, 2011, and specifically operative for business tax incentives allowed by acts that take effect beginning 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.

ANALYSIS

<u>THIS BILL</u>

This bill would require a taxpayer doing business in the state under the Personal Income Tax Law (PITL) or the CTL that claims a business tax incentive to annually 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 is allowed by an act that takes effect in a taxable year beginning on or after January 1, 2011, if the taxpayer has a disqualifying event occur before the close of the recapture period, the business tax incentive would be subject to recapture.

- A disqualifying event would be defined as a net decrease (see the discussion on the calculation on page 3 of this analysis) in the average number of full time equivalent employees, calculated as of the last day of the current taxable year.
- Recapture period would mean the first full taxable year beginning after the close of the taxable year in which the business tax incentive reduces either the taxpayer’s taxable income (PITL), net income (CTL), net tax (PITL), or tax (CTL), and the four succeeding taxable years.

"Business tax incentive" would mean a credit, deduction, exclusion, exemption, or any other tax benefit provided by the state that is added by an act that takes effect beginning on or after January 1, 2011, and enacted with the 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.

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.

Employees in the state who are employed in any trade or business sold by a taxpayer would be excluded in the determination of the net decrease in full-time equivalent employees.

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.

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.

<u>Recapture Provisions</u>

If there is a disqualifying event, the recaptured amount would be added to income or tax in the taxable year the disqualifying event occurs, including the interest amount.

The recapture amount would be computed by multiplying the total amount of the current taxable year's business tax incentive and prior taxable years excluding the amounts previously recaptured, by a fraction, the numerator which is the net decrease in full-time equivalent employees and the denominator which is the cumulative increase in the full-time equivalent employees calculated from the last day of the first taxable year the business tax incentive was claimed on the return to the last day of the taxable year immediately preceding the taxable year of the disqualifying event.

- If the denominator of the fraction equals zero or a negative amount, 100 percent of the business tax incentive would be subject to recapture.

- If the fraction is greater than one, not more than 100 percent of the business tax incentive could be subject to recapture.

The interest amount would be computed using the adjusted annual rate from the due date of the return for each taxable year in which the business tax incentive reduced a taxpayer's income or tax to the date of the payment of the additional tax.

The amount of recapture computed would first be applied against the applicable business tax incentives that reduced income or tax for the earliest taxable year, and then to the succeeding taxable years. If there is any remaining recapture amount, the excess would be applied against remaining carryovers of the business tax incentives.

The recapture amount would be in addition to any other recapture amounts imposed under the PITL or the CTL.

Under PITL, this bill would not apply to a taxpayer with 25 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 the CTL, this bill would not apply to a taxpayer with 25 or fewer employees and with income subject to tax of less than $500,000.

Assigned Business Tax Incentives (CTL Only)

This bill provides the following rules for business tax incentives that could be sold, assigned, or transferred (assigned):

- Any business tax incentive that is allowed to be assigned, would only be valid if the seller or assignor expressly agrees to provide the buyer or assignee and the FTB in the form and manner specified by the FTB, any necessary information to calculate whether a disqualifying event has occurred with respect to the seller or assignor.

- If a disqualifying event occurs, the buyer or assignor would be required to include in income or tax the amount of any required recapture.

- The assignment and recapture rules would apply to any business tax incentive that is assigned under the CTL.

- A notice of proposed deficiency assessment attributable to the business tax incentive to which the reporting requirements were not met could be mailed to the buyer or assignee within four years from the date on which the reporting requirements are met by the seller or assignor. The four-year period does not start until all of the information needed to satisfy the reporting requirements is provided.

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.

Penalties

The amount of the understatement of tax for the taxable year that is attributable to the disallowance or recapture of a business tax incentive would exclude from the calculation of any penalty under the PITL, CTL, and the Administration of Franchise and Income Tax Laws and Regulations.

LEGISLATIVE STAFF CONTACT

Legislative Analyst	Revenue Manager	Legislative Director
Gail Hall	Monica Trefz	Brian Putler
(916) 845-6111 gail.hall@ftb.ca.gov	(916) 845-4002 monica.trefz@ftb.ca.gov	(916) 845-6333 brian.putler@ftb.ca.gov

APPENDIX A
RESOLVED IMPLEMENATION AND TECHNICAL CONSIDERATIONS

Resolved Implementation Considerations As Discussed In The Department's Analysis of the Bill As Amended August 2, 2010

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, vocation 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.

Resolved Technical Considerations As Discussed In The Department's Analysis of the Bill As Amended August 2, 2010

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.