

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Aanestad Analyst: Gail Hall Bill Number: SB 939
Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: February 3, 2010
Attorney: Patrick Kusiak Sponsor:

SUBJECT: Enterprise Zone Employer Wages Credit/Taxpayers In Oroville Enterprise Zone May Sell Credits

SUMMARY

This bill would allow a taxpayer in the Oroville enterprise zone (EZ) to sell certain credits for Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) purposes.

PURPOSE OF THE BILL

According to the author's staff, this bill would stimulate investment and job creation for businesses in the Oroville EZ.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

ANALYSIS

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.

FEDERAL LAW

Existing federal law provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

Board Position:

_____ S _____ NA _____ NP
_____ SA _____ O _____ NAR
_____ N _____ OUA X PENDING

Department Director

Date

Selvi Stanislaus

04/30/10

STATE LAW

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an EZ. Using specified criteria, the DHCD designates EZs from the applications received from the governing bodies. EZs are designated for 15 years (except EZs meeting certain criteria may be extended to 20 years), and DHCD is authorized to designate 42 EZs under current law (42 currently are designated). When an EZ expires, DHCD is authorized to designate another in its place to maintain a total of 42 EZs. DHCD may approve the geographic expansion of EZs up to 15 percent in size and, for certain small EZs, up to 20 percent in size.

Under the Revenue and Taxation Code (R&TC), existing state law provides special tax incentives for taxpayers conducting business activities within an EZ. These incentives include a sales or use tax credit, hiring credit, business expense deduction, special net operating loss treatment, and net interest deduction. In addition, specified employees of businesses operating in an EZ may claim a wage credit.

Hiring Credit

A business located in an EZ may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an EZ 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 EZ and at least 50 percent must be performed inside the EZ. The business may claim up to 50 percent of the wages paid to a qualified employee as a credit against tax imposed on income earned within the EZ.

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 enterprise zone, 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. Certain criteria regarding who may be qualified employees and certain limitations differ between the various economic development areas.

For businesses operating inside and outside an EZ, the amount of credit that may be claimed is limited by the amount of tax on income attributable to the EZ. EZ income is first apportioned to California using the same formula used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor). This income is then further apportioned to the EZ using a two-factor formula based on the property and payroll of the business.

Assignment of Credits (Applicable To CTL Only)

Current law allows the assignment of certain credits, including the EZ, to taxpayers under CTL that are members of a combined reporting group and includes the following provisions:

- Provides that an “eligible credit” may be assigned by a taxpayer to an “eligible assignee.”
 - “Eligible credit” means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that is eligible to be carried forward to the taxpayer’s first taxable year beginning on or after July 1, 2008.
 - “Eligible assignee¹” means any “affiliated corporation” that is properly treated as a member of the same combined reporting group.
 - “Affiliated corporation” means a corporation that is a member of a commonly controlled group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer’s original return for the taxable year in which the assignment is made.
- Gives the FTB authority to issue rules, procedures, guidelines, and regulations necessary to implement this provision.

THIS BILL

This bill provides that it is the intent of the Legislature that any income derived from the sale of tax credits pursuant to this bill be used by the selling business for the expansion of business activities, the hiring of staff, the purchase of capital, or for any other business operational expense related to maintaining the businesses within the Oroville EZ.

This bill would permit a taxpayer located in the Oroville EZ to sell its EZ Hiring Credits to an unrelated party. In addition, this bill would provide the following provisions:

- The taxpayer would be required to report to the Franchise Tax Board (FTB) prior to the sale of the hiring credit all required information² regarding the purchase and sale of the credit.
- The credit may be sold to any unrelated taxpayer, but could not be resold by the unrelated party to another taxpayer or other party.
- A party that has acquired an Oroville EZ Hiring Credit would be subject to current state law’s EZ Hiring Credit requirements. For example, if a taxpayer sells its Oroville EZ Hiring Credit to an unrelated party, the unrelated party may only utilize the purchased credit to reduce tax generated from operating in the Oroville EZ.

¹ See R&TC section 23663(b) for the different rules on who can assign or receive credits.

² Includes social security or other taxpayer identification number of the buyer and amount of consideration received by the seller for the sale of the credit.

- A taxpayer would be prohibited from assigning or selling any EZ Hiring Credit to the extent the credit is claimed on any tax return of the taxpayer.
- In the event that both the taxpayer originally allocated an EZ Hiring Credit and a taxpayer that purchased the hiring credit both claim the same amount on their tax return, the FTB could disallow the credit of either taxpayer, if the period for making an assessment remains open.

This bill applies to both PITL and CTL.

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.

1. It is unclear if Oroville EZ Hiring Credit carryovers earned prior to the operative date of this bill would be allowed to be sold. If the author's intent is to allow the carryovers from previous years to be sold, a clarifying amendment is recommended. (See attached Amendments 1 and 5).
2. It is unclear what "unrelated party" means, in part because under the Revenue and Taxation Code, taxpayers are currently treated as "related" under various sections using different criteria and different thresholds of common ownership. The author may want to define this term to avoid conflicts between the taxpayer and the department.
3. This bill would require that the taxpayer report to the FTB prior to the sale of the credit. The author should consider amending this requirement to have the taxpayer report the sale of the credit on the original tax return in a form and manner determined by the FTB. This would remove the administrative burden of tracking stand-alone forms received by the FTB and increase accuracy of the reported information because the sale would have already occurred.
4. Under existing provisions of the CTL, certain taxpayers that are unitary affiliates are expressly permitted to assign a tax credit to a related party. If the author wants to prohibit an unrelated party that purchased an EZ Hiring Credit from assigning the credit to a related party, an amendment would be necessary.
5. The tax consequences to the seller and purchaser of the Oroville EZ Hiring Credit relating to the compensation paid for the credit is unclear. If the author would like to specify that the income received by the selling taxpayer would not be considered gross income for state purposes, and the purchase by the unrelated party would not be considered deductible for state purposes, attached Amendments 3 and 7 are necessary.

6. On pages 11 and 20, it appears the author in paragraph 6 of subdivision (k) is trying to add some anti-abuse provisions to ensure a taxpayer and an unrelated party do not both claim the same EZ Hiring Credit on their separate tax returns. The author should consider deleting paragraph 6 and adding a new paragraph that provides that the taxpayer and unrelated party would be jointly and severally liable for any post-assignment adjustments to credits. (See Amendments 2 and 6.)
7. A taxpayer or an unrelated party may not realize that even if an EZ Hiring Credit is sold, the FTB may audit this credit for compliance purposes. It is recommended that the author consider adding an amendment to clarify this point. (See attached Amendments 4 and 8.)

TECHNICAL CONSIDERATIONS

The department 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.

- On page 11, line 3, the words "assigned or" should be deleted because there is no provision in PITL that would allow a tax credit to be assigned.
- On page 11, line 6, and page 20, line 25, the word "allocated" should be changed to "earned" because the EZ Credit is not an allocated tax credit, but instead is earned by a taxpayer.

LEGISLATIVE HISTORY

AB 2562 (Vargas, 2001/2002) would have allowed a taxpayer that operated a business in an EZ to transfer that credit to any other taxpayer in this state. AB 2562 did not pass the Senate Committee on Governmental Organization.

ABX3 15 (Krekorian, Stats. 2010, 3d Ex. Sess., 2009, Ch. 10) and SBX3 15 (Calderon, Stats. 2010 3d Ex. Sess., 2009, Ch. 17) included a provision that created a new California Film & Television Tax Credit and permitted credits attributable to an independent film to be sold to an unrelated party.

FISCAL IMPACT

This bill would require a taxpayer to report to the FTB, prior to the sale of a credit, specified information in a form and manner determined by the FTB. As a result, this bill would impact the filing and audit processes. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation may be requested, if necessary.

ECONOMIC IMPACT

Estimated Revenue Impact of SB 939 As Introduced February 3, 2010 For Taxable Years Beginning After January 1, 2010 Enactment Assumed September 30, 2010 (\$ in Millions)		
2011-12	2012-13	2013-14
-\$1.5	-\$1.6	-\$1.7

LEGISLATIVE STAFF CONTACT

Legislative Analyst
Gail Hall
(916) 845-6111
gail.hall@ftb.ca.gov

Revenue Manager
Monica Trefz
(916) 845-4002
monica.trefz@ftb.ca.gov

Legislative Director
Brian Putler
(916) 845-6333
brian.putler@ftb.ca.gov

Anal yst	Gai l Hal l
Tel ephone #	(916) 845-6111
At t or ney	Pat Kusi ak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 939

Amendment 1

On page 10, line 24, after "section" insert:

, including credit carryovers from previous years,

Amendment 2

On page 11, delete lines 6 through 10, and insert:

(6) The taxpayer and the unrelated party shall be jointly and severally liable for any tax, addition to tax, or penalty that results from the disallowance, in whole or in part, of any credit sold or purchased under this subdivision.

Amendment 3

On page 11, after line 10, insert:

(7) For purposes of this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001), no amount paid by the unrelated party to the taxpayer for the purchase of the credit under this subdivision shall be includable in the gross income of the taxpayer or deductible by the unrelated party.

Amendment 4

On page 11, before subdivision (l), insert:

(8) Nothing in this subdivision shall limit the authority of the Franchise Tax Board to audit either the taxpayer or the unrelated party with respect to any credit sold or purchased pursuant to this subdivision.

Amendment 5

On page 20, line 4, after "section" insert:

, including credit carryovers from previous years,

Amendment 6

On page 20, delete lines 25 through 29, and insert:

(6) The taxpayer and the unrelated party shall be jointly and severally liable for any tax, addition to tax, or penalty that results from the disallowance, in whole or in part, of any credit sold or purchased under this subdivision.

Amendment 7

On page 20, after line 29, insert:

(7) Any consideration paid by the unrelated party to the taxpayer for the purchase of the credit under this subdivision would be reported as follows:

(A) No deduction shall be allowed to the unrelated party under this part with respect to the amount paid, and

(B) No amounts so received by the taxpayer shall be includable in gross income under this part.

Amendment 8

On page 20, before subdivision (1), insert:

(8) Nothing in this subdivision shall limit the authority of the Franchise Tax Board to audit either the taxpayer or the unrelated party with respect to any credit sold or purchased pursuant to this subdivision.