

Franchise Tax Board

**ANALYSIS OF ORIGINAL BILL**

Author: Dutton Analyst: Angela Raygoza Bill Number: SBX6 11  
Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: February 24, 2010  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Employer Hiring Credit

**SUMMARY**

This bill would allow a tax credit for wages paid by a qualified employer to qualified employees, as defined.

**PURPOSE OF THE BILL**

According to the author’s office, the purpose of this bill is to stimulate the economy by providing a tax benefit for businesses.

**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.

**SUMMARY OF SUGGESTED AMENDMENTS**

The following suggested amendments are provided to resolve some of the technical considerations. The technical considerations without suggested amendments would require additional information.

- Amendments 1 and 5 would correct a referencing error,
- Amendments 2 and 6 would provide standard carryover language, and
- Amendments 3 and 4 would define “wages.”

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## 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 tax credit (WOTC).<sup>1</sup> 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.

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 tax credit for employees working in an EZ.

**Hiring Credit:** 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.

Newly enacted state tax law SBX3 15 (Calderon, Stats. 2010, 3<sup>rd</sup> Ex. Sess. 2009, Ch. 17) allows a tax 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 (FTB) 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.

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<sup>1</sup> Internal Revenue Code (IRC) section 51

THIS BILL

Beginning on or after January 1, 2010, this bill would provide a tax credit to a qualified taxpayer for wages paid or incurred to a qualified employee in an amount equal to the following:

- 25 percent for an employee that is employed for at least 120 hours, but less than 400 hours, and
- 40 percent for an employee that is employed at least 400 hours.

The credit would be allowed for the first \$6,000 of wages paid or incurred to each qualified employee during the taxable year.

This bill would define the following:

- “Qualified employee” means an individual who is any of the following, as documented by the Employee Development Department (EDD):
  - A recipient of CalWORKs benefits,
  - A parolee,
  - A veteran, as defined in Section 980 of the Military and Veterans Code,
  - An eligible recipient of unemployment insurance benefits,
  - A recipient of unemployment insurance benefits, and
  - A person on probation.
- “Qualified taxpayer” means a taxpayer that is a person or entity engaged in a trade or business within California that has its principal office located in California.

This bill would require the qualified taxpayer to comply with the following:

- Obtain a certificate from the EDD certifying that a qualified employee is employed by the qualified taxpayer, and
- Retain a copy of the certificate and provide it upon request to FTB.

This bill would provide rules for aggregating affiliated employers for purposes of determining the credit. This bill would require that the credit be calculated by using a trade or business' proportionate share of qualified wage expenses. In addition, for any calendar year ending after an acquisition of a major portion of a trade or business of another employer or of a separate unit, the employment relationship between a qualified employee and an employer would not be treated as terminated if the qualified employee continues to be employed in that trade or business.

This bill would reduce the expense deduction for wages paid to qualified employees by the amount of the credit.

This bill would allow the credit to be carried over to future years until exhausted.

## IMPLEMENTATION CONSIDERATIONS

Because EDD would certify that the qualified employee meets the requirements of this bill, the department would have no implementation concerns with the bill.

## TECHNICAL CONSIDERATIONS

On page 3, line 16, and page 5, line 4, this bill specifies the credit would be reduced by subdivision (g). Subdivision (g) references unlimited credit carryovers, not reductions. It is recommended that the bill be amended to delete this reference. Please see Amendments 1 and 5.

The carryover language would require a taxpayer to add a prior year's credit to the credit for the current year. Credit carryovers are calculated reducing the tax to zero and carrying over remaining credits to the next year. It is recommended that the bill be amended to remove the language and replace with the standard carryover over language. Please see Amendments 2 and 6.

The term "wages" is undefined. The absence of a definition to clarify "wages" could lead to disputes with taxpayers and would complicate the administration of this credit. It is recommended to limit credible wages to wages subject California's Unemployment Insurance Code. Please see Amendments 3 and 4.

This bill provides rules for aggregating affiliated employers for purposes of determining an employee tax credit. Because this bill lacks language to limit the number of employees and the amount of wages paid per employer, the rules for aggregating employers are unnecessary. It is recommended that the bill be amended to delete these provisions.

This bill does not limit the credit to California wages. It appears that the author intends to limit this credit to the payment of California wages. If this is the author's intent, it is recommended to limit the credible wages to those paid for services in California.

This bill requires certification with the EDD that a qualified employee is employed by the qualified taxpayer. This could be construed to require an annual certification by the EDD. It is suggested the bill be amended to require certification that an employee is a qualified employee as defined by the bill.

## **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 1973 (Swanson, 2009/2010) would provide a tax credit for a qualified employee who is an ex-offender employed as a part-time or full-time. The amount of the credit is equal to 20 percent of the gross salary for a qualified employee. This bill is currently on suspense in 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 located in the Assembly Revenue and Taxation Committee..

AB 2630 (Emmerson/Cook, 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 will be heard in the Assembly Revenue and Taxation Committee on May 10.

SB 508 (Dutton, 2009/2010) and SBX8 59 (Dutton, 2009/2010) are identical to this bill. SB 508 failed passage out of the Senate Revenue and Taxation Committee by the constitutional deadline. SBX8 59 failed passage out of the Senate Rules Committee.

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 (Krekorian, Stats. 2010, 3<sup>rd</sup> Ex. Sess. 2009, Ch. 10) and SBX3 15 (Calderon, Stats. 2010, 3<sup>rd</sup> Ex. Sess. 2009, Ch. 17) provide 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 not significantly impact the department's costs.

## ECONOMIC IMPACT

This bill would result in the following revenue losses:

Estimated Revenue Impact of SBX6 11 Introduced on February 24, 2010 For Taxable Years Beginning On or After January 1, 2010 Enactment on September 30, 2010 (\$ in Billions)			
Fiscal Year	2010-11	2011-12	2012-13
Revenue Loss	-\$3.5	-\$4.0	-\$3.6

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

## POLICY CONCERNS

Because this bill fails to specify otherwise, a taxpayer could potentially claim the credit proposed by this bill, the newly enacted Job Tax Credit (Calderon, Stats. 2009 Third Extraordinary Session, Ch. 17), the Enterprise Zone Hiring Credit, and the Local Agency Military Base Recovery Credit using the same employee wages. Generally, a credit is allowed in lieu of any deduction or credit already allowable for the same item of expense to eliminate multiple tax benefits.

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.

This credit would be limited to an employer whose principal office is 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

This bill would provide an incentive to an employer who pays a maximum of \$6,000 of wages to qualified employees who works less than 400 hours per year, thereby encouraging an employer to hire five qualified employees per year for a credit of \$30,000 rather than one qualified employee for 2,000 hours for a credit of \$6,000. Consequently, part-time employment may increase at the expense of full-time employment.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO SBX6 11  
As Introduced February 24, 2010

AMENDMENT 1

On page 3, strikeout line 16 and insert:  
credit.

AMENDMENT 2

On page 3, strikeout lines 17-22, and insert:  
(g) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and succeeding years if necessary, until the credit is exhausted.

AMENDMENT 3

On page 3, after line 25 insert:  
(3) "Wages" means the amount of wages subject to Chapter 6 (commencing with 13000) of Part 6 of Division 6 of the Unemployment Insurance Code.

AMENDMENT 4

On page 4, line after line 13, insert:  
(3) "Wages" means the amount of wages subject to Chapter 6 (commencing with 13000) of Part 6 of Division 6 of the Unemployment Insurance Code.

AMENDMENT 5

On page 5, strikeout line 4 and insert:  
credit.

AMENDMENT 6

On page 5, strikeout lines 5-10, and insert:  
(g) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years if necessary, until the credit is exhausted.