

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Dutton Analyst: Angela Raygoza Bill Number: SB 508  
Related Bills: See Legislative History Telephone: 845-7814 Introduced Date: February 26, 2009  
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, 2009.

## POSITION

Pending.

## 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 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 which 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).

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

Board Position:	Department Director	Date
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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. 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.

### THIS BILL

Beginning on or after January 1, 2009, this bill would provide a tax credit for 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.
- 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, or
  - A recipient of unemployment insurance benefits.
- “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 with 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

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.

On page 3, line 13, and page 4, line 39, 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 the reference to subdivision (g).

The bill does not limit the wages to California employees. It appears that the author intends to limit the wages paid to only California employees. A technical amendment is offered to accomplish this result.

## **LEGISLATIVE HISTORY**

AB 340 (Knight, 2009/2010) would provide 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 is currently in the Assembly Revenue and Taxation Committee.

SB 612 (Runner, 2009/2010) would provide a tax credit of \$500 per month for each qualified employee employed by a taxpayer. This bill is currently in the Senate Revenue and Taxation Committee.

ABX3 15 (Stats. 2009, Ch. 10) and SBX3 15 (Stats. 2009, Ch. 17) provide a tax credit of \$3,000 for each net job increase.

AB 2365 (Correa, 2003/2004) would have allowed a credit for wages paid to a qualified employee who is hired in the taxpayer's manufacturing trade or business. This bill failed passage out of the Assembly Appropriations Committee.

SB 1523 (Ashburn, 2003/2004) would have allowed a hiring credit to employers with fewer than 19 employees. This bill failed passage out of the Senate Appropriations Committee.

SB 1876 (Alpert, 2003/2004) would have, among other things, created a Living Wage Opportunity and Revitalization Credit and repealed the Economically Developed Area (EDA) hiring credits. This bill was amended on April 29, 2004, to be a California earned income tax credit. This bill failed passage out of the Senate Appropriations Committee.

## **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

If the implementation 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 SB 508 As Introduced On February 26, 2009 For Taxable Years Beginning On or After January 1, 2009 Enactment Assumed After June 30, 2009 (\$ in Billions)			
Fiscal Year	2009-10	2010-11	2011-12
Revenue Loss	-\$1.5	-\$1.9	-\$2.5

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 would depend on the amount of wages paid to qualified employees by qualified employers and the amount of credits that would be used to offset tax liabilities in each year.

This estimate was developed in the following steps:

Step 1- Estimate the number of qualified employees for each of the four targeted classes:

#### Unemployed – 1.56 million

Based on data from the Bureau of Labor Statistics and the Current Population Survey, it is estimated that 30 percent of new hires had been formerly unemployed. The data revealed that approximately 45 percent of the labor force finds a new job at some point during a year. This figure is based on an annualized average using labor turnover percentages for the last six months of 2008. [(12.7 million in private employment x 45%) – 0.5 million new entrants into labor force] x 30% ≈ 1.56 million]

Veterans – 1.19 million

According to Census data, approximately 55 percent of California's 2.8 million veterans are employed. Approximately, 77 percent of employees work for the private sector, resulting in 1.19 million military veteran employees (2.8 million veteran's employed x 55% x 77%  $\approx$  1.19 million)

Cal-Works – 51,000

Department of Social Services data indicate approximately 51,000 Cal-Works recipients are employed.

Parolees – 37,000

Bureau of Justice Statistics data was used to derive an estimated population of approximately 120,000 parolees annually in California. It is estimated that approximately 30% of them will become employed in any given year. (120,000 x 30%  $\approx$  37,000)

TOTAL – 2.70 million qualified employees

The 2.84 million total (1.56 + 1.19 + .05+ .04) would be reduced by 5 percent to account for overlap among the four subgroups. (2.84 million employees x 95%  $\approx$  2.70 million)

Step 2- For purposes of this estimate it was assumed that 90 percent of employees would qualify their employer for the \$2,400 credit for the maximum credit of 40 percent of wages. The remaining 10 percent would yield an average credit of \$1,000 for the minimum credit of 25 percent of wages. This would total approximately \$6.1 billion [(2.7 million x 90% x \$2,400) + (2.7 million x 10% x \$1,000)] in credits. The \$6.1 billion in credits would be reduced by 8 percent because employers would be unable to claim a deduction for wages included in the credit, resulting in total credits of approximately \$5.6 billion (\$6.1 billion x 92%).

For the 2009 taxable year, it is estimated that 80 percent or \$4.5 billion (\$5.6 billion x 80%) of the credits generated would be claimed because of sufficient tax liability. Of the \$4.5 billion claimed (\$5.6 billion x 80%), it is assumed approximately \$2.7 billion (\$4.5 billion x 60%) would be claimed on original 2009 income tax returns and approximately \$1.2 billion (\$4.5 billion x 26%) would be accrued to fiscal year 2009-10 from amended income tax returns, and the remaining \$600,000 would be claimed in subsequent years.

It is assumed that 20 percent or approximately \$800 million (\$3.9 billion x 20%) of the accrued \$3.9 billion (\$2.7 billion from 2009 returns + \$1.2 billion accrued to fiscal year 2009-10) could be applied against 2009 tax liabilities. Beginning in tax year 2010, the remaining \$3.1 billion of credits (\$3.9 billion - \$800 million) would be carried forward and used equally over the next eight years at a rate of \$390 million per year. (\$3.1 billion in credits  $\div$  8 years to carryover  $\approx$  \$390 million)

In addition, for taxable year 2010, approximately \$1.2 billion in generated credits would be projected for a total of approximately \$1.6 billion (\$1.2 billion generated credits in 2010 + \$390 million in carryovers) in revenue losses. Approximately one-half of the \$1.6 billion impact for tax year 2010, or approximately \$750 million (\$1.6 billion x 50%), is assumed to be realized during the 2009-10 fiscal year from reduced estimated tax payments, for a total impact in 2009-10 of approximately \$1.5 billion (\$800 million for the 2009 taxable year + \$750 million for the 2010 taxable year).

This analysis assumes that only California employees qualify the employer for the credit, although the bill does not contain this limitation. In addition, the estimate assumes that the credit would only be allowed for a taxable year in which the employee was unemployed. Thus, an employer could not claim the credit in tax year 2011 for an employee who was not unemployed during that tax year.

## **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 2000 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 SB 580  
As Introduced February 26, 2009

AMENDMENT 1

On page 2, after line 22 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 2

On page 3, line after line 31, 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.