

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Walters Analyst: William Koch Bill Number: SB 1179
Related Bills: See Legislative History Telephone: 845-4372 Amended Date: April 10, 2012
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Credit For Hiring Disabled Veterans

SUMMARY

This bill would provide a \$3,000 tax credit for each disabled veteran hired by a qualified employer, as specified, limited to a cumulative total of allowable credit of \$100 million.

RECOMMENDATION

No position.

Summary of Amendments

The April 10, 2012, amendments deleted spot bill language in the bill and added the provisions discussed in this analysis.

REASON FOR THE BILL

It appears the reason for this bill is to reduce the number of unemployed disabled veterans.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and by its own terms, would be operative for taxable years beginning on or after January 1, 2013, and would be repealed on December 1 of the year after the year in which the allowable credit limit is reached

ANALYSIS

FEDERAL LAW

Under existing federal law, the Work Opportunity Tax Credit (WOTC) program, an employer may qualify for a tax credit of 40 percent of the qualified first-year wages, as specified, paid to an employee that is a member of a designated target group, including certain categories of qualified veterans, as specified. The maximum amount of qualified first-year wages that may be included in the credit calculation varies depending upon the individual veteran's qualifying category as shown below:

Board Position:

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Executive Officer

Date

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- \$6,000 for an individual that is a qualified veteran because they:
 - Are a member of a family receiving Food Stamps, or
 - Have an aggregate period of unemployment equal to or exceeding 4 weeks (but less than 6 months) during the one year period ending on the hiring date.
- \$14,000 for a qualified veteran that has an aggregate period of unemployment equal to or exceeding 6 months during the one-year period ending on the hiring date.

The maximum qualified first-year wages that may be included in the calculation of the credit is greater for veterans that are entitled to compensation for a service connected disability, and are currently:

- \$12,000 for a qualified veteran entitled to compensation for a service connected disability that has a hiring date that is not more than one year after having been discharged or released from active duty.
- \$24,000 for a qualified veteran entitled to compensation for a service connected disability that has an aggregate period of unemployment during the one year period ending on the hiring date equal to or exceeding six months.

STATE LAW

The New Jobs Credit enacted in 2009 allows a 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) on a first-come-first-served basis 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.

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 including a 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. Any credits not used in the taxable year may be carried forward until they are exhausted.

PROGRAM BACKGROUND

As of April 7, 2012, the total Personal Income Tax and Business Entity returns claiming the New Jobs Tax Credit was 16,534, and the amount of credits generated was approximately \$98 million. The credit will remain in effect until the criteria for the cut-off date has been met. The cut-off date is the last day of the calendar quarter within which the FTB estimates it will have received timely filed original returns claiming the credit that cumulatively total \$400 million.

THIS BILL

This bill would, for taxable years beginning on or after January 1, 2013, provide a tax credit for a qualified employer in the amount of \$3,000 for each increase in qualified full-time employees hired during the taxable year, determined on an annual full-time equivalent basis. Any credits not used in the taxable year may be carried over for up to eight years.

This bill provides the following definitions:

- “Qualified employer” means a taxpayer that is primarily engaged in the lines of business classified in Code 339113 (Surgical Appliance and Supplies Manufacturing) of the North American Industry Classification System (NAICS) published by the United State Office of Management and Budget, 2012 edition. Examples of products manufactured by such businesses include orthopedic devices, prosthetic appliances, surgical dressings, crutches, surgical sutures, hospital beds, and operating room tables.
- “Qualified full-time employee” means an employee who is a disabled veteran, as defined in Section 999 of the Military and Veterans Code¹, who was (1) paid qualified wages during the taxable year by the qualified employer for services of not less than an average of 35 hours per week, or (2) was a salaried employee and was paid compensation during the taxable year for full-time employment, within the meaning of Section 515 of the Labor Code², by the qualified employer.
- “Qualified employee” would not include an employee (1) certified as a qualified employee in an enterprise zone or targeted tax area, (2) certified as a qualified disadvantaged individual in a manufacturing enhancement area, or (3) whose wages are included in calculating any other credit allowed.
- “Annual full-time equivalent” means either of the following:
 1. In the case of a full-time employee that is paid hourly, the total number of hours worked for the taxpayer by the employee (not to exceed 2000 hours) divided by 2000.
 2. In the case of a salaried full-time employee, the total number of weeks worked for the taxpayer divided by 52.

¹ Military and Veterans Code Section 999(b)(6) defines "disabled veteran" as a veteran of the military, naval, or air service of the United States, including, but not limited to, the Philippine Commonwealth Army, the Regular Scouts, "Old Scouts," and the Special Philippine Scouts, "New Scouts," who has at least a 10-percent service-connected disability and who is domiciled in the state.

² Labor Code Section 515(c) defines "full-time employment" as employment in which an employee is employed for 40 hours per week.

- “Qualified wages” means wages to subject to Division 6 of the Unemployment Insurance Code (California wage withholding).

This bill would provide that the net increase in qualified employees would be determined on an annual full-time equivalent basis by comparing the number of full-time employees employed by the taxpayer in the current taxable year with the number of qualified full-time employees that were employed by the taxpayer in the preceding taxable year. For taxpayers who first commenced doing business in the state during the taxable year, the number of qualified full-time employees for the immediately preceding taxable year would be zero.

Any deduction an employer is allowed for qualified wages would not be reduced by the amount of the credit allowed by this bill. Taxpayers would only be able to claim this credit on an original timely filed return received by the FTB on or before a cut-off date specified by the FTB, which would be the last day of the calendar quarter within which the FTB estimates it will have received timely filed original returns claiming the credit that cumulatively total \$100 million for all taxable years. The date received on a return would be determined by the FTB. Determinations made by the FTB with respect to the cut-off date, the date a return is received, and whether a return has been timely filed would not be reviewable in any administrative or judicial proceeding.

In addition, any disallowance of the credit due to the cumulative total of the credit being reached would be treated as a math error, and would not be subject to review in any administrative or judicial proceeding.

This bill would require the FTB to provide periodic notice on its website of the amount of the credit claimed on timely filed original returns and would allow the FTB to prescribe rules, guidelines, or procedures necessary to carry out the provisions of the bill. Any rules, guidelines or procedures established would be exempt from the Administrative Procedures Act.

The credit allowed by this bill would remain in effect only until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and would be repealed as of that date.

IMPLEMENTATION CONSIDERATIONS

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

This bill fails to provide an exemption from the underpayment of estimated tax penalty to the extent the penalty is attributable to the disallowance of the credit due to the \$100 million cap and cut-off date. To avoid disputes between taxpayers and the FTB, the author may wish to amend the bill to add language similar to the language contained in Revenue and Taxation Code Section 19136.8, which provides an underpayment of estimated tax penalty exemption relating to the \$400 million cap and cut-off date for the New Jobs Credit.

TECHNICAL CONSIDERATIONS

Delete lines 10 and 11 on page 2, and lines 18 and 19 on page 5, as the term “acquire” is already defined in Revenue and Taxation Sections 17276.20(f)(6) and 24416.20(g)(6) and would be applicable to this bill.

On page 2, line 22, and page 5, line 30, between “qualified” and “employee” insert:

“full-time”

LEGISLATIVE HISTORY

SB 1197 (Calderon, 2011/2012) would establish an income tax credit for wages paid to a qualified veteran, as specified. SB 1197 is currently referred to the Senate Governance and Finance Committee.

SB 1056 (Denham, et al., 2009/2010) would have provided a tax credit in an amount equal to 25 percent of the qualified wages, not to exceed \$6,000, paid to employees who are qualified veterans. SB 1056 failed passage out of the Senate Committee on Revenue and Taxation.

SBX6 7 and SBX8 63 (Denham, et al., 2009/2010) would have provided a tax credit in an amount equal to 25 percent of the qualified wages, not to exceed \$6,000, paid to employees who are qualified veterans. SB X6 7 failed passage out of the Senate Committee on Revenue and Taxation. SBX8 63 failed to move out of the Senate Rules Committee.

ABX3 15 (Ch. 10, Stats. 2009) and SBX3 15 (Ch. 17, Stats. 2009) created the New Jobs Tax Credit, which provides a tax credit of \$3,000 for each net job increase, as specified.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

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. These credits would be applicable, but not limited, to employees that are veterans.

Illinois allows a credit in an amount equal to 10 percent, but no greater than \$1,200 of the gross wages paid by a taxpayer to a qualified veteran in the course of that veteran's sustained employment during the taxable year.

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. This credit would be applicable, but not limited, to employees that are veterans.

Michigan and Minnesota do not offer wage credits.

New York law provides for several wage based credits. The Excelsior jobs tax credit is a credit for each net new job created in New York State and is calculated as 6.85 percent of gross wages. The credit for employing a disabled person is equal to 35 percent of the first \$6,000 in “qualified first-year wages” earned by each qualified employee. If the “qualified first-year wages” also qualified for the federal WOTC for vocational rehabilitation referrals, a credit is allowed for 35 percent of the first \$6,000 in “qualified second-year wages” paid to each qualifying employee. These credits would be applicable, but not limited, to employees that are veterans.

FISCAL IMPACT

This bill would require the FTB to revise the tax forms and instructions, make changes to tax return processing systems and procedures, and monitor the allowance of the credit in order to ensure the cap of \$100 million is not exceeded. As a result, this bill would increase the department’s operating costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

| Estimated Revenue Impact of SB 1179 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2012 | | |
|---|------------|------------|
| 2012-13 | 2013-14 | 2014-15 |
| -\$200,000 | -\$600,000 | -\$800,000 |

This estimate does not account for changes in employment, personal income, or gross state product that could result from this bill.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: It could be argued that this bill would stimulate job creation by offering a tax incentive to businesses that have the ability to employ new workers and expand their current workforce.

Opponents: Some taxpayers may say that with the state’s current fiscal crisis, additional tax expenditures should be avoided.

POLICY CONCERNS

This bill specifies any deduction otherwise allowed for qualified wages shall not be reduced by the amount of the credit allowed by this bill. As a result, a taxpayer could claim the credit proposed by this bill and a deduction for 100 percent of the wages the credit was based upon. Generally, a credit is allowed in lieu of any deduction or credit already allowable in order to eliminate multiple tax benefits.

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