

SUMMARY ANALYSIS OF AMENDED BILL

Author: Yee Analyst: David Scott Bill Number: SB 364
 Related Bills: See Prior Analysis Telephone: 845-5806 Amended Dates: April 25, 2011, and May 3, 2011
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Business Tax Incentive Reporting Information and Penalty

SUMMARY

This bill would require taxpayers that claimed a business tax incentive to report certain employment information to the Franchise Tax Board (FTB) and the Board of Equalization (BOE) and would assess a penalty if the taxpayer’s California employment levels decreased by more than 10 percent from the prior year.

This analysis will not address the bill’s changes to the Sales and Use Tax Law, as they do not impact the department or state income tax revenue.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

SUMMARY OF AMENDMENTS

The April 25, 2011 amendments resolved some of the implementation considerations as discussed in the department’s analysis of the bill as amended March 21, 2011. Additionally, the April 25, 2011, amendments remove the penalty from the Personal Income Tax Laws (PITL) and Corporation Tax Laws (CTL) sections and placed the penalty in the Administration – Franchise and Income Tax Laws (AFITL). As a result of the April 25, 2011, amendments, the department has identified additional implementation, technical, and policy concerns. Amendments have been provided to resolve the technical considerations. For convenience, all new and existing unresolved previous implementation considerations are provided below. The “This Bill” discussion has been revised. The remainder of the department’s analysis of the bill as amended March 21, 2011, still applies.

The May 3, 2011, amendments revised the language that limits the amount of the penalty in the AFITL section of the Revenue and Taxation Code.

Board Position:	Asst. Legislative Director	Date
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ANALYSIS

THIS BILL

This bill would require a taxpayer doing business in the state that claims a business tax credit to annually submit certain information to the FTB. The information must be on a timely filed original return and includes the number of full-time equivalent employees, as defined, employed by the taxpayer in the state for the current and prior taxable year.

This bill would:

- assess a penalty of \$5,000 (or fractional portion thereof) for each full-time equivalent employee or fractional portion for taxable years beginning on or after January 1, 2012, under the following conditions:
 - The taxpayer has used a business tax credit added by an act that takes effect on or after January 1, 2012, and
 - The taxpayer has a decrease in total California employment of more than 10 percent measured against the prior year, based on the number of full-time equivalent employees.

The bill would be effective and operative for taxable years beginning on or after January 1, 2012.

The penalty would be limited to the amount of business tax credits the taxpayer claimed on their California franchise or income tax returns for the preceding three taxable years. For example, if a taxpayer generated total business tax credits of \$30,000 for taxable years 2012 - 2014, and then, in taxable year 2015, had a decrease in total California employment of ten full-time equivalent employees more than 10 percent, then the \$50,000 tentative penalty computed on the reduction would be limited to \$30,000—the total amount of the business tax credits claimed in the three taxable years immediately prior to the 2015 taxable year.

The three-year look-back period, for purposes of the penalty limitation, would be limited to post-2011 years. In the case of a 2013 taxable year, the penalty would be limited to credits claimed in 2012 and forward, not the full three years the statute specifies.

The bill defines "business tax credit" to mean a credit, based on qualified wages or the number of employees employed, which is available for use against the "net tax" or "tax" due the state, resulting from an act that is added and takes effect beginning on or after January 1, 2012.

Calculation of the Penalty for Net Decrease in Full-time Employees

The penalty is imposed when there is a greater than 10 percent net decrease in California full-time employee equivalents, as follows:

- Ninety percent of the annual full-time equivalent employees, including any fractional portions, for the preceding calendar year, less
- The total annual full-time equivalent employees, including any fractional portions, for the current calendar year, multiplied by
- Five thousand dollars (\$5,000).
- If the computed reduction in annual full-time equivalent employees is zero or less, the penalty is zero.

This bill would provide the following definitions:

- “Qualified wages” would mean wages subject to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.
- “Full-time equivalent” would mean either of the following:
 - In the case of an employee paid hourly qualified wages, the total number of hours worked for the taxpayer by the employee (not to exceed 1,820 hours per employee) divided by 1,820.
 - In the case of a salaried employee, the total number of weeks worked for the taxpayer by the employee divided by 52.
- “Qualified taxpayer” would mean any person (including any business entity) engaged in or carrying on a trade, business, profession, vocation, calling or commercial activity in the state and pays qualified wages to more than 100 annual full-time equivalent employees, including the employees of a trade or business acquired during the calendar year. The bill uses the rules for determining if a business is a new business for net operating loss (NOL) purposes to determine if the acquired business is included in the calculation of annual full-time equivalent employees.

In addition, the bill would provide that all employees of the trades or businesses that are treated as related under either Section 267, 318, or 707 of the Internal Revenue Code would be treated as employed by a single taxpayer.

The bill also requires the taxpayer to report the number of annual full-time equivalent employees employed for the preceding and current taxable years on a timely filed original California tax return. The bill imposes a penalty of an unspecified amount for failure to report the information.

The bill also requires taxpayers that sell, assign, or transfer business tax credits to other members of the combined reporting group to continue to report the information necessary to determine if a penalty should be imposed under this new section added by the bill. The FTB has four years from the date the information is provided to send a notice of proposed assessment to the assignee, transferee, or buyer of the business tax credits.

IMPLEMENTATION CONSIDERATIONS

The department had identified the following implementation consideration in the department's analysis of the bill as amended March 21, 2011. This implementation consideration still applies.

- The bill is silent as to how to measure changes in employment when one of the two tax periods being compared is a short period of less than a full year. This would make the comparison between taxable years difficult. One possible method would be to annualize the short period's employment calculation so that the comparison is on equal terms.

The department has identified the following implementation considerations with the bill as amended April 25, 2011.

- The April 25, 2011, amendments added tests for determining if an entity acquired during the current taxable year should be included in the calculation of FTEs for the taxable year. The tests added were by reference to the tests under the NOL provisions used in determining whether a trade or business qualifies as a new business for NOL purposes. Using the referenced NOL tests for this provision could lead to some confusion by taxpayers because the tests deal with the value of assets acquired and the fair market value of those assets and are silent regarding employees. The bill as amended on April 25, 2011, contains multiple businesses and related party aggregation rules; the NOL tests are unnecessary. If there are specific tests the author would like to use to clarify when a new acquisition should be included in the calculation of FTEs, then language for the test should be included in the bill. It is recommended that the reference to the NOL tests be deleted.
- The bill is silent as to the amount of the penalty for failure to report the required employment information on its originally filed tax return. The amount is necessary for FTB to assess the penalty.

TECHNICAL CONSIDERATIONS

In Section 3 of the bill, addressing the income or franchise tax section of the bill, the reporting requirements for the number of full-time equivalent employees are based on taxable year, whereas the penalty computation, in the same section, is based on the calendar year. The bases should be the same. Amendments 2 and 3, provided below, would resolve this concern.

The April 25, 2011, amendments moved the penalty provisions from the PITL and CTL to the AFITL. As a result, the reference in subdivision (f) to credits sold, assigned, or otherwise transferred under the provisions of this part are no longer applicable. The references should be modified to the correct Revenue and Taxation Code references. Amendments 4 and 5, provided below, would resolve this concern.

Paragraph (g)(3) of Section 19137 of the language as amended April 25, 2011, provides that the FTB has the authority to audit the information provided by the taxpayer; however, this authority is already granted in R&TC section 19504. Leaving this paragraph in the bill could imply that each code section would need specific authority for the FTB to audit; therefore, amendment 6, attached, has been provided to delete this paragraph.

FISCAL IMPACT

This bill would require the department to do the following:

- 1) Modify tax forms;
- 2) Make system and procedure changes to track the annual employment information required to be reported on the original tax return;
- 3) Determine if a penalty should be assessed; and
- 4) Validate the employment information provided.

As a result, this bill would impact the department's printing, processing, and data storage costs. The additional costs will be developed as the implementation concerns are resolved and the bill moves through the legislative process.

Revenue Estimate

This bill would not impact the state's income tax revenue because provisions of the current tax law regarding business tax incentives are unchanged.

POLICY CONCERNS

The bill defines "business tax credit" using the term "qualified wages." "Qualified wages" are defined in this bill as wages subject to a specific division of the Unemployment Insurance Code. This would enable a waged based "business tax credit" bill to be enacted after January 1, 2012, and use something other than "qualified wages" as defined in this bill. This could lead to disputes as to whether this provision applies. Suggested Amendment 1 (attached below) would expand the definition of a "business tax credit" to include employee compensation, which would include, but not be limited to, "qualified wages" as defined in this bill.

The bill is ambiguous regarding the responsibility for paying the penalty when the credits have been sold, assigned, or transferred. This could lead to disagreements with taxpayers. The entity that generated the credit, based on its employment, would be the logical choice to be responsible for reporting the required annual employment information. The entity that generated the credit should also be responsible for the penalty, because it is the entity that had the more than 10 percent drop in California full-time equivalent employees

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO
SB 364 as Amended on May 3, 2011

AMENDMENT 1

On page 5, line 8, after based on" insert:

Employee compensation that includes

AMENDMENT 2

On page 5, line 37, strikeout "calendar" and insert:

taxable

AMENDMENT 3

On page 5, line 39, strikeout "calendar" and insert:

taxable

AMENDMENT 4

On page 6, line 27, strikeout "this part" and insert:

Part 10 (commencing with 17001), this part, or Part 11 (commencing with 23001)

AMENDMENT 5

On page 7, strikeout line 1 and insert:

Part 10 (commencing with 17001), this part, or Part 11 (commencing with 23001), notwithstanding any other provision of Part 10 (commencing with 17001), this part, or Part 11 (commencing with 23001) to the

AMENDMENT 6

On page 7, strikeout lines 18 through 20, inclusive.