

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Runner Analyst: Jahna Alvarado Bill Number: SB 640

Related Bills: See Legislative History Telephone: 845-5683 Introduced Date: February 18, 2011

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Hiring Credit/ Qualified Full Time Employees Who Have Received Unemployment Insurance Benefits For Not Less Than 6 Months Prior To Hiring

SUMMARY

This bill would provide a tax credit for a taxpayer who employs qualified employees.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide a tax incentive to encourage employers to hire individuals receiving unemployment insurance benefits.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be specifically operative for taxable years beginning on or after January 1, 2011.

ANALYSIS

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's trade or business, including employee wages and benefits.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers that incur certain expenses 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.

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FEDERAL LAW

Current federal law allows employers who hire employees from a “targeted group,” as defined, to elect to claim a work opportunity credit (WOTC).¹ 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).

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 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.

The Corporation Tax Law (CTL) allows the assignment of certain eligible credits to taxpayers that are members of a combined reporting group. “Assignment” refers to the ability of a taxpayer that is a member of a combined reporting group to elect to transfer certain unused credits to a related corporation, as specified. The election to transfer 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.

¹ Internal Revenue Code (IRC) 51.

THIS BILL

For taxable years beginning on or after January 1, 2011, this bill would allow a tax credit in an amount equal to \$500 per month for each qualified employee employed in a qualified job by the taxpayer. The maximum total amount of the credit that could be allowed for each qualified employee per taxable year would be \$6,000.

This bill would define the following terms:

- “Qualified amount” would be equal to the sum of \$500 per month for each qualified employee employed by the taxpayer in a qualified job, multiplied by the number of consecutive calendar months, not to exceed 12 consecutive months, that the taxpayer employs the qualified employee in a qualified job.
- “Qualified employee” means any person who received unemployment insurance benefits for not less than an unspecified period, prior to the time he or she was hired by the taxpayer for a qualified job.
- “Qualified job” means a non-seasonal, full-time employment position within the State of California that would qualify the employee for benefits under the Unemployment Insurance Code, excluding any benefits received under the Unemployment Insurance Code,² and result in a minimum salary of \$1,000 in any month in which the taxpayer seeks to apply the credit.

This bill would allow unused credits to be carried over for six years.

The corporate credit would be eligible for assignment, as specified.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high level discussion; additional concerns may be identified as the bill moves through the legislative process. In order for the FTB to implement this bill, clarification is necessary for the following issues.

This bill uses the undefined terms, “nonseasonal, full-time employment position,” and “unemployment insurance benefits.” The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit. For example, unemployment benefits paid by a jurisdiction outside of California could generate the credit. If this is contrary to the author’s intention, this bill should be amended. The author may wish to consider the definition of “qualified full-time employee” contained in the existing hiring credit.³

Because this bill would require an individual to have received unemployment insurance benefits for a specified period to qualify for the credit, an individual that had been unemployed for the specified period who was ineligible for unemployment insurance benefits would fail to qualify for the credit. If this is contrary to the author’s intention, this bill should be amended.

² Unemployment Insurance Code section 1279.5-defines unemployed and unemployment benefits.

³ Revenue and Taxation Code sections 17053.80(b)(2) and 23623(b)(2).

The FTB lacks the ability to verify the minimum duration of receipt of unemployment insurance benefits that this bill would require. Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. For example, for individuals receiving benefits from the state of California, the Employment Development Department could serve as the certifying agency. The certification language would specify the responsibilities of both the certifying agency and the taxpayer.

While this bill specifies that an employer can claim a credit of \$500 per month for each qualified employee, multiplied by the number of consecutive calendar months, not to exceed 12 consecutive months, it is unclear if the bill actually limits the employer to a \$6,000 credit per qualified employee. For example, an employer could claim a tax credit for 11 months, reduce the employee's wages below the \$1,000 threshold for a month or terminate the employee and then rehire the employee the next month and begin the consecutive 12-month period over again for the same employee. If it is the author's intent to provide a limit on the credit, it is recommended that the bill be amended to specify the limit amount.

It is unclear whether a partial month of employment would be included in the number of consecutive calendar months that this credit would be based on. Lack of clarity could lead to disputes between taxpayers and the department. It is recommended that the treatment of partial months of employment be clarified to avoid confusion and ease administration of this credit.

Because this bill is silent on the timing of a person's receipt of unemployment insurance benefits, the population of "qualified employees" may be overly broad. As defined, any person that had, over the course of their employment history received at least six months of benefits, would be a "qualified employee." Further, when the definition of "qualified employee" is met, the person would continue to be a "qualified employee" for each future "qualified job" that they are hired to fill. If it is the author's intention to encourage employment of individuals that are unemployed as of their hire date and have been unemployed for a minimum of six months immediately prior to that hire date, this bill should be amended to clarify that intent.

TECHNICAL CONSIDERATIONS

On page 2, line 16, and page 3, line 4, strikeout the phrase "seeks to apply the credit" and replace with the phrase "for any month for which the credit is allowed" to provide clarity and consistency with recently enacted tax credit terminology.

LEGISLATIVE HISTORY

AB 304 (Knight, 2011/2012) would allow a credit of \$3,000 or \$5,000 to an employer with 30 or more employees that moves or establishes a headquarters within California. This bill is currently in the Assembly Revenue and Taxation Committee.

AB 1009 (Wieckowski, 2011/2012) would modify the current New Jobs Tax Credit to increase the allowance of the credit from employers with less than 20 employees to employers with 100 or less employees. This bill is currently in the Assembly Revenue and Taxation Committee.

SB 156 (Emmerson/Cook, 2011/2012) would modify the current New Jobs Tax Credit to increase the allowance of the credit from employers with less than 20 employees to employers with 50 or less employees. This bill is currently in the Senate Committee on Appropriations.

AB 340 (Knight, 2009/2010) would have allowed a hiring credit to employers who established a headquarters within California. This bill failed passage out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 2617 (Tran, 2009/2010) would have provided 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 failed passage out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 2630 (Emmerson, et al., 2009/2010) would have provided 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 was 5.5 percent or lower. This bill failed passage out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

SB 508 (Dutton, 2009/2010), SBX6 11 (Dutton, 2009/2010), and SBX8 59 (Dutton, 2009/2010) are identical. These bills would have provided a tax credit for the first \$6,000 of wages paid or incurred to an individual documented by the Employee Development Department. SB 508 failed passage out of the Senate Revenue and Taxation Committee by the constitutional deadline; SBX6 11 (Dutton, 2009/2010) failed passage out of the Senate Revenue and Taxation Committee; and SBX8 59 failed passage out of the Senate Rules Committee by the constitutional deadline.

SB 612 (Runner, 2009/2010) would have provided a tax credit of \$500 per month for each qualified employee employed by a taxpayer. The tax credit that SB 612 would have provided is substantially similar to the credit this bill would allow. SB 612 bill failed passage out of the Senate Revenue and Taxation Committee by the constitutional deadline.

ABX3 15 (Krekorian, Stats. 2010, 3rd Ex. Sess. 2009, Ch. 10) and SBX3 15 (Calderon, Stats. 2010, 3rd Ex. Sess. 2009, Ch. 17) created the New Jobs Tax Credit, which provides a tax credit of \$3,000 for each net job increase.

OTHER STATES' INFORMATION

Florida allows businesses a credit of \$1,000 for each person who was unemployed for at least 30 days immediately before being hired by an eligible business. This credit is set to expire as of June 30, 2012. Other wage-based credits are offered to businesses that are located in an EZ, high crime, or rural area.

New York allows a credit for hiring a person with a disability that is equal to 35 percent of the first \$6,000 in "qualified first-year wages" earned by each qualified employee. *New York* also allows the Excelsior jobs tax credit and a credit for qualified emerging technology companies. Although the Empire Zone Program sunset as of June 30, 2010, the Empire Zone tax incentives, including the wage credit, remains available to businesses that were certified prior to the sunset date.

Illinois allows a job tax credit for taxpayers conducting a trade or business in an EZ or a High Impact Business, in a River Edge Redevelopment Zone, or a federally designated Foreign Trade Zone or Sub-zone. The credit is \$500 for each eligible employee hired to work in the zone during the tax year. The credit 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 and technical considerations addressed in this analysis are resolved, the department's costs to implement this bill are expected to be minor.

ECONOMIC IMPACT

The revenue impact of this bill would be revenue losses estimated in the billions of dollars per year. This level of loss occurs because employers could report this credit for current employees as well as newly hired employees as long as the individual had received at least six months of unemployment insurance benefits. Additionally, because the bill fails to limit the credit to one taxable year or to a specific period of employment (i.e., the initial 12 months of employment), employers could continue to report the credit as long as the qualified employee remains employed in a qualified job. As a result, the bill as currently drafted would result in billions of dollars of credits generated each year.

SUPPORT/OPPOSITION

Support: None identified to date.

Opposition: None identified to date.

ARGUMENTS

Pro: A credit for hiring individuals unemployed for a lengthy period could encourage hiring in this targeted group and reduce the burden on the state's unemployment insurance resources.

Con: Targeting a hiring credit to a specific group during a time of record unemployment could be seen as providing an unfair advantage to the targeted group.

POLICY CONCERNS

Because this bill fails to specify otherwise, a taxpayer could claim the credit proposed by this bill, a deduction for qualified wages, the EZ Hiring Credit or the LAMBRA Credit, and the New Jobs Credit (Calderon, Stats. 2009 Third Extraordinary Session, Ch. 17) 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 in order 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.

LEGISLATIVE STAFF CONTACT

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