

ANALYSIS OF AMENDED BILL

Author: Fox, et al. Analyst: Jessica Deitchman Bill Number: AB 2389
 See Legislative
 Related Bills: History Telephone: 845-6310 Amended Date: June 25, 2014
 Attorney: Bruce Langston Sponsor _____

SUBJECT:	New Advanced Strategic Aircraft Program For The US Air Force Employment Credit
-----------------	--

SUMMARY

Among other things, this bill would, under the Corporation Tax Law (CTL), allow a tax credit for certain qualified taxpayers that hire employees to manufacture certain property for the United States Air Force.

This analysis discusses only the provisions of the bill that would impact the department.

RECOMMENDATION

No position.

Summary of Amendments

The June 26, 2014, amendments removed the provisions related to the department of transportation and added provisions related to an employment credit. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for the bill is to incentivize large manufacturing businesses to invest in California.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2015, and before January 1, 2030.

FEDERAL/STATE LAW

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.

Existing federal law provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

Board Position:	Executive Officer	Date									
<table style="width: 100%; border: none;"> <tr> <td style="width: 33%;"><u> </u> S</td> <td style="width: 33%;"><u> </u> NA</td> <td style="width: 33%;"><u> </u> X</td> </tr> <tr> <td><u> </u> SA</td> <td><u> </u> O</td> <td><u> </u> NP</td> </tr> <tr> <td><u> </u> N</td> <td><u> </u> OUA</td> <td><u> </u> NAR</td> </tr> </table>	<u> </u> S	<u> </u> NA	<u> </u> X	<u> </u> SA	<u> </u> O	<u> </u> NP	<u> </u> N	<u> </u> OUA	<u> </u> NAR	Selvi Stanislaus	07/02/14
<u> </u> S	<u> </u> NA	<u> </u> X									
<u> </u> SA	<u> </u> O	<u> </u> NP									
<u> </u> N	<u> </u> OUA	<u> </u> NAR									

Current state law allows a New Hiring Tax Credit that is available to a qualified taxpayer that hires a qualified full-time employee, has an overall net increase in employment, and pays or incurs qualified wages attributable to work performed by the qualified full-time employee in a designated census tract¹ or former Enterprise Zone.² The qualified taxpayer must receive a tentative credit reservation from the Franchise Tax Board (FTB) for that qualified full-time employee.

State and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, unless specifically excluded by statute, including, wages paid to employees.

THIS BILL

For taxable years beginning on or after January 1, 2015, and before January 1, 2030, this bill would provide a tax credit to a qualified taxpayer in an amount equal to 17 ½ percent of qualified wages paid or incurred by the qualified taxpayer during the taxable year to qualified full-time employees multiplied by an annual full-time equivalent ratio.

The bill would define the following terms:

- “Annual full-time equivalent” means either:
 - In the case of an employee paid hourly, the total number of hours worked for the qualified taxpayer by the qualified employee divided by 2,000.
 - In the case of a salaried employee, the total number of weeks worked by the qualified employee for the qualified taxpayer divided by 52.
- “Annual full-time equivalent ratio” means a ratio that cannot be greater than one, the numerator of which is 1,100 and the denominator of which is the number of qualified taxpayer’s qualified full-time employees computed on an annual full-time equivalent basis for the taxable year.
- “Qualified full-time employee” means an individual that is employed in this state by the qualified taxpayer and satisfies both of the following:
 - The individual’s services for the qualified taxpayer are at least 80 percent directly related to the qualified taxpayer’s subcontract to design, test, manufacture property, or otherwise support production of property for ultimate use in or as a component of a new advanced strategic aircraft for the United States Air Force.

¹ A census tract within the state that is determined by the Department of Finance to have a civilian unemployment rate that is within the top 25 percent of all census tracts within the state and has a poverty rate within the top 25 percent of all census tracts within the state.

² “Former enterprise zone” means an enterprise zone designated as of March 1, 2012, and any expansion of an enterprise zone prior to December 31, 2012, as in effect on December 31, 2012, excluding any census tract within an enterprise zone that is identified by the Department of Finance as a census tract with the lowest civilian unemployment and poverty.

- The individual is paid compensation from the qualified taxpayer that satisfies either of the following conditions:
 - Was paid qualified wages for services of not less than an average of 35 hours per week, or
 - Was a salaried employee and was paid compensation during the taxable year for full-time employment.³
- “Qualified Taxpayer” means any taxpayer that is a major first-tier subcontractor awarded a subcontract to manufacture property for ultimate use in or as a component of a new advanced strategic aircraft for the United States Air Force.
 - “Major first-tier subcontractor” means a subcontractor that was awarded a subcontract in an amount of at least 35 percent of the initial prime contract awarded for the manufacturing of a new advanced strategic aircraft for the United States Air Force.
- “Qualified Wages” means wages paid or incurred by the qualified taxpayer during the taxable year with respect to qualified full-time employees that are direct labor costs⁴, allocable to property manufactured in this state by the qualified taxpayer for ultimate use in or as a component of a new advanced strategic aircraft for the United States Air Force.
- “New Advanced Strategic Aircraft for the US Air Force” means a new advanced strategic aircraft developed and produced for the United States Air Force under the New Advanced Strategic Aircraft Program.
- “New Advanced Strategic Aircraft Program” means the project designed to design, test, manufacture, or otherwise support production of a new advanced strategic aircraft for the United States Air Force under a contract that is expected to be awarded in the first or second calendar quarter of 2015.

The total aggregate amount of the credit that may be allowed to all qualified taxpayers would be:

- In years one through five of the credit, the total aggregate amount allowed shall not exceed \$25,000,000 per calendar year.
- In years six through ten of the credit, the total aggregate amount allowed shall not exceed \$28,000,000 per calendar year.
- In years 11 through 15 of the credit, the total aggregate amount allowed shall not exceed \$31,000,000 per calendar year.

³Within the meaning of Section 515 of the Labor Code.

⁴ Within the meaning of Section 263A of the Internal Revenue Code relating to capitalization and inclusion of inventory costs of certain expenses.

The FTB would allocate the credit on a first-come-first-served basis to the taxpayers that claim the credit on a timely filed original return.

Credit amounts in excess of the tax may be carried over for a maximum of eight years, if necessary, until exhausted.

This credit would be in lieu of any other credit that is based up on the same qualified wages.

The credit would only be allowed to qualified taxpayers that reduced the bid upon which the taxpayer's subcontract to manufacture property for the ultimate use in or as a component of a New Advanced Strategic Aircraft for the US Air Force is based by a good faith estimate of the amount of the credit allowable under this section.

All reference to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a subcontract for which a qualified taxpayer is making claim, shall be made available to the FTB upon request.

The FTB may prescribe regulations necessary or appropriate to carry out the purposes of this section.

The FTB may also prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this section.⁵

This section would remain in effect only until December 1, 2030, and would be repealed by its own terms as of that date.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

LEGISLATIVE HISTORY

SB 90 (Galgiani and Canella, Chapter 70, Statutes of 2013), modified AB 93 as chaptered on July 11, 2013. Specifically, SB 90, for purposes of the new hiring tax credit, modified the definition of qualified employee, excluded sexually oriented businesses from the definition of qualified taxpayer and small business, and modified the defined geographical area that the hiring credit may be generated in.

AB 93 (Assembly Committee on Budget, Chapter 69, Statutes of 2013), repealed the geographically targeted economic development area tax incentives and the New Jobs Tax Credit under the Personal Income Tax Law (PITL) and the CTL, created a New Hiring Tax Credit under the PITL and CTL, established the California Competes Tax Credit Committee, and created the California Competes Tax Credit under the PITL and CTL.

⁵ Chapter 3.5 (commencing with Section line 14 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any rule, guideline, or procedure prescribed by the FTB pursuant to this section.

OTHER STATES' INFORMATION

Review of *Illinois, Florida, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax credits. These states were selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

Staff estimate a one-time cost to the department of \$82,000 for the development, testing, and programming of the existing systems.

ECONOMIC IMPACT

Estimated Revenue Impact of AB 2389* As Amended June 25, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions)		
2014-15	2015-16	2016-17
- \$18	- \$25	- \$25

*The estimate assumes the cap will be reached in each calendar year.

This analysis 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: Some may argue that the bill would encourage large companies that manufacture items for the US Air Force to locate in California, creating new, long-term high-paying jobs.

Opponents: Some may argue that providing a tax credit limited to corporations manufacturing items for the US Air Force may be overly narrow thus limiting the potential for job creation.

POLICY CONCERNS

This bill would provide a tax benefit, under the CTL, for hiring employees to manufacture property, or otherwise support production of property for ultimate use in or as a component of a new advanced strategic aircraft for the United States Air Force that would not be provided under the PITL to other business entities. Thus, this bill would provide differing treatment based solely on business type.

This bill would allow a credit for wages paid to qualified employees that are currently deductible as business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310

jessica.deitchman@ftb.ca.gov

Mandy Hayes
Revenue Manager, FTB
(916) 845-5125

mandy.hayes@ftb.ca.gov

Jahna Carlson
Asst. Legislative Director, FTB
(916) 845-5683

jahna.carlson@ftb.ca.gov