

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Muratsuchi Analyst: Michelle Chan Bill Number: AB 927
Related Bills: See Legislative History Telephone: 845-6805 Amended Dates: April 1 & 8, 2013
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Hiring Credit/Aerospace Employers Who Hire New Full-Time Employees and Veterans

SUMMARY

This bill would create a tax credit under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) for an aerospace employer that hires certain new employees.

RECOMMENDATION

No position.

Summary of Amendments

The April 1, 2013, amendments added provisions that would allow an aerospace employer a tax credit for each new qualified employee, as discussed in this analysis, to the bill's provision, as introduced February 22, 2013, relating to sales and use taxes.

The April 8, 2013, amendments removed the provision of the bill relating to sales and use taxes and modified the PITL and CTL credit as discussed in this analysis, and made several technical, nonsubstantive changes.

This analysis only addresses the provisions of the bill that impact the department's programs and operations. This is the department's first analysis of the bill.

Summary of Suggested Amendments

An amendment has been suggested under the "Technical Consideration" discussion to address an inconsistency in the calculation of the net increase in qualified full-time employees.

REASON FOR THE BILL

The reason for the bill is to encourage aerospace companies to stimulate job creation and the economy by providing hiring incentives.

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, 2014.

Board Position:			
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Executive Officer	Date
Selvi Stanislaus	5/3/13

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state 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.

Additionally, current 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.

Current California law allows a New Jobs Tax Credit for taxable years beginning on or after January 1, 2009, for a qualified employer in the amount of \$3,000 for each increase in the number of qualified full-time employees hired in the taxable year, determined on an annual full-time equivalent basis.¹ A qualified employer is one that employs 20 or fewer employees. The credit has a cap of \$400 million for all taxable years. The Franchise Tax Board (FTB) is responsible for determining the cut-off date (the last day of the quarter in which the \$400 million cap will be reached), after which claims for the credit will no longer be allowed. The credit statute 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 taxable 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 hiring 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.

¹ ABX3 15 (Stats. 2009, Ch. 10) and SBX3 15 (Stats. 2009, Ch. 17)

The 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.

THIS BILL

This bill would, for taxable years beginning on or after January 1, 2014, allow a credit for a qualified employer in the following amounts:

- \$3,000 for each increase in qualified full-time employees hired during the taxable year, determined on an annual full-time equivalent basis, and
- An additional \$1,000 for each qualified full-time employee hired during the taxable year if the qualified full-time employee is a veteran or an additional \$2,000 for each qualified full-time employee hired during the taxable year if the qualified full time employee is a service-connected disabled veteran.

Any credits not used in the taxable year may be carried over until the credit is exhausted. The total amount of credits allowed to a qualified employer shall not exceed \$5,000,000 for all taxable years.

This bill would define the following terms and phrases:

- "Qualified employer" means a taxpayer who employed qualified full-time employees who are located in this state and meets any of the following:
 1. The taxpayer manufactures, assembles, tests, renovates, or converts aircraft and spacecraft.
 2. The taxpayer manufactures or designs aircraft or spacecraft engines and engine parts.
 3. The taxpayer manufactures or designs aircraft and spacecraft auxiliary components, including detection equipment, navigation, and guidance systems.
 4. The taxpayer provides aircraft and spacecraft support services, including launching, operating, and retrieving air and space vehicles.
 5. The taxpayer is a military contractor that is involved with aerospace defense, including the manufacturing of missiles and military airplanes.

- “Qualified full-time employee” means either of the following:
 1. An employee who was paid wages subject to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code by the qualified employer for services of not less than an average of 35 hours per week.
 2. An employee who 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.

- “Annual full-time equivalent” means either of the following:
 1. In the case of a full-time employee paid hourly qualified wages, “annual full-time equivalent” means the total number of hours worked for the taxpayer by the employee (not to exceed 2,000 hours per employee) divided by 2,000.
 3. In the case of a salaried full-time employee, “annual full-time equivalent” means the total number of weeks worked for the taxpayer by the employee divided by 52.

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, inclusive of the number of employees employed by a trade or business acquired by the taxpayer during the current taxable year, with the number of qualified full-time employees employed by the taxpayer in the preceding taxable year, inclusive of the number of employees employed by a trade or business acquired by the taxpayer during 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.

All employees of the trades or businesses that are treated as related under either Section 267, 318, or 707 of the Internal Revenue Code³ shall be treated as employed by a single taxpayer.

Taxpayers would only be able to claim this credit on an original timely filed return received by the FTB. The total amount of credits that may be allowed by this bill shall not exceed \$35,000,000 for a calendar year. The credits would be allowed to a taxpayer on a first-come, first-served basis. The date a return is received would be determined by the FTB. Determinations made by the FTB with respect to the date a return is received and whether a return has been timely filed would not be reviewable in any administrative or judicial proceeding.

Additionally, 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.

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

³ Losses, expenses, and interest with respect to transactions between related taxpayers, constructive stock ownership, and transactions between partner and partnership.

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.

IMPLEMENTATION CONSIDERATIONS

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

This bill would allow an additional credit for the hiring of certain veterans. It is unclear how the additional credit would relate to the credit for each increase in qualified full-time employees hired during the taxable year as determined on an annual full-time equivalent basis. For example, if a taxpayer has a net increase of full time employees of 3.5 for a single year and the taxpayer hired four veterans and five disabled veterans during that year, would the net increase be rounded to a whole number? Rounded up or rounded down? Assuming that net increase would be rounded up to 4, which 4 employees would be creditable? The first 4 hired or the 4 that generate the largest credit amount? In order to avoid disputes between taxpayers and the department, this bill should be amended for clarification.

The total amount of credits that may be allowed by this bill could not exceed \$35,000,000 for a calendar year. There are fiscal year filers as well as calendar year filers. As a result there could be instances where returns for two different taxable years of fiscal year taxpayers could be received in the same calendar year which could complicate the administration of this credit. The author may consider amending the bill to reference all taxable years instead of calendar year.

This bill would limit the total amount of credits allowed to a qualified employer to \$5,000,000 for all taxable years. The bill is silent as to how the credit limitation would apply to mergers and split ups. It could be interpreted that the credit limitation would start over if the entity reorganizes. If this is contrary to the author's intent, the bill should be amended.

A taxpayer that had the credit disallowed solely because the calendar year (\$35 million) or qualified employee limitation (\$5 million) had been reached could be subject to underpayment penalties. If this is contrary to the author's intent, this bill should be amended.

This bill uses terms and phrases that are undefined, i.e., "qualified wages," "military contractor involved with aerospace defense," "veteran," and "service-connected disabled veteran." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of the credit.

TECHNICAL CONSIDERATIONS

The calculation of the net increase in qualified full-time employees excludes the increase in employees attributable to the purchase of a trade or business during the current taxable year. Page 8, line 32, needs to be amended where the term "preceding" appears, as it should be "current" to properly exclude employee growth due to the acquisition of an existing business.

LEGISLATIVE HISTORY

AB 1326 (Gorell and Bradford, 2013/2014) would create a tax credit for wages paid by employers to qualified employees that produce unmanned aerial vehicles. AB 1326 has been referred to the Assembly Revenue and Taxation Committee.

SB 414 (Knight, 2013/2014) would create two income tax credits for qualified employers in the aerospace sector. The first tax credit would be for costs paid to reimburse qualified employees for tuition costs. The second tax credit would be for wages paid to certain qualified employees that receive an undergraduate or graduate degree in the state. SB 414 is currently set for hearing before the Senate Governance and Finance Committee on May 8, 2013.

AB 2304 (Wyman, 2001/2002) would have created an income tax credit for wages paid by an employer for work performed on items installed in aircraft. AB 2304 was held under submission in the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states do not offer a credit similar to the credit proposed in this bill. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

Department staff is unable to determine the costs to administer this bill until the implementation concerns have been resolved. As the bill continues to move through the legislative process and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 927 As Amended April 8, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 (\$ in Millions)		
2013-14	2014-15	2015-16
- \$9.2	- \$28.0	- \$31.0

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

LEGAL IMPACT

This bill would restrict this tax credit to certain Aerospace employers who employ qualified full-time employees located within California. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to improperly favor in-state activity over out-of-state activity. On August 28, 2012, (*Cutler v. Franchise Tax Board*), the Court of Appeal issued a unanimous opinion holding that California's Qualified Small Business Stock statutes were unconstitutional. Specifically, the Court of Appeal held that the statutory scheme's requirement of a large California presence in order to qualify for an investment incentive discriminated against interstate commerce, and therefore violated the federal dormant commerce clause. While no court decision has yet invalidated, as a general matter, state income tax credits that provide an incentive for in-state activity, i.e., property placed in service in the state, employees employed in the state, or employers located in the state, etc., targeted tax credits such as the one proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION

Support: None Provided.

Opposition: None Provided.

ARGUMENTS

Proponents: Supporters could argue that the tax credit provided by 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 could argue that California's economic recovery remains fragile and the state should avoid any additional tax expenditures.

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. Additionally, because this bill fails to specify otherwise, multiple credits based on the same wage expenditures would be allowed. Generally, a credit is allowed in lieu of any deduction or credit already allowable 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 a 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.

LEGISLATIVE STAFF CONTACT

Michelle Chan

Legislative Analyst, FTB

(916) 845-6805

Michelle.Chan@ftb.ca.gov

Mandy Hayes

Revenue Manager, FTB

(916) 845-5125

Mandy.Hayes@ftb.ca.gov

Jahna Carlson

Acting Asst. Legislative Director, FTB

(916) 845-5683

Jahna.Carlson@ftb.ca.gov