Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Knight	Analyst:	Jane Raboy	Bill Number:	SB 414
Related Bills:	See Legislative History	Telephone:	845-5718	Introduced Date:	February 20, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Tuition or Wages Paid to Aerospace Industry Employees Credit

SUMMARY

This bill would create two tax credits under Personal Income Tax Law and Corporation Tax Law for qualified employers engaged in the aerospace sector.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to stimulate job creation for math or engineering graduates and allow California to keep pace with competing states in the aerospace industry.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2013.

ANALYSIS

FEDERAL 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.

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Federal law provides individuals with two types of education-related tax credits: the American Opportunity Credit and the Lifetime Learning Credit. The American Opportunity Credit (AOC) can be claimed for the first four years of postsecondary learning. Generally, the AOC requires a taxpayer to meet all of the following: qualified tuition and related expenses are paid for an eligible student; and the tax return shows the eligible student claimed as an exemption.

A Lifetime Learning Credit is available for qualified tuition and related expenses paid by an individual at the undergraduate or graduate level. The credit is calculated as a percentage of the qualified educational expenses paid. There is no limit on the number of years the credit can be claimed for each eligible student.

STATE LAW

California does not have a comparable American Opportunity Credit or Lifetime Learning Credit.

The New Jobs Credit[1] 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. Any credits not used in the taxable year may be carried forward up to eight years.

Enterprise zones (EZs) were created in California to provide tax incentives for businesses located in a designated enterprise zone. The program offers hiring and sales and use tax credits as special tax incentives.

THIS BILL

For taxable years beginning on or after January 1, 2013, this bill would create two tax credits for a qualified employer engaged in the aerospace sector.

1. Tuition Reimbursement Tax Credit

This provision would create a tax credit for a qualified employer, equal to 50 percent of the tuition reimbursed to a qualified employee as well as the following:

- Limit the tax credit to 50 percent of the average annual tuition paid by a qualified employee for postsecondary educational costs at the University of California or the California State University, excluding cost for books, fees, or room and board,
- Allow a qualified employer a tax credit for the first four years of employment for each qualified employee, and
- Grant the Franchise Tax Board (FTB) the authority to prescribe rules, guidelines or procedures necessary to carry out its provisions while excluding the authority under the Government Code from applying.

[11] Although the New Jobs Credit is referred to as the "Small Business Hiring Credit" in the California Income Tax Expenditures report for December 2009 (updated 06/2012)< https://www.ftb.ca.gov/aboutftb/Tax_Expenditure_Report_2009.pdf>, the name in common use on the department's forms, instructions, and website is used in this analysis.

2. Qualified Wages Paid Tax Credit

This provision would create a tax credit for a qualified employer equal to a percent of qualified wages, for each qualified employee employed during the taxable year that receives a postsecondary degree from a public or private college or university, calculated as follows:

- 10 percent of qualified wages for in-state studies; or
- 5 percent of qualified wages for out-of-state studies.

The amount of the credit would be limited to $12,500 for each qualified employee per taxable year and allowed only for the first five years of employment.

This bill uses phrases that are defined under both tax credits as follows:

- "Full-time" means either the employee is paid wages subject to the Unemployment Insurance Code for a minimum of 35 hours per week or the employee is salaried and was paid qualified wages during the taxable year for full-time employment, within the meaning of Section 515 of the Labor Code.
- "Qualified employee" means a person who is employed by a qualified employer or contracts with an employer for a full-time position in a qualified industry with the state within one year of being awarded an undergraduate or graduate engineering degree from a recognized accreditor in applied science, the Accreditation Board for Engineering and Technology, and was not employed by any qualified employer for work in a qualified industry prior to his or her current employment or contract.
- "Qualified employer" means a person or entity who is engaged in a trade or business in a qualified industry.
- "Qualified industry" means the manufacturer of aerospace or defense hardware or software, aerospace maintenance, aerospace repair and overhaul, parts supply to the aerospace industry, provision of services and support relating to the aerospace industry, research and development of aerospace technology and systems, and the education and training of aerospace personnel.
- “Qualified wages” means wages subject to withholding under the Unemployment Insurance Code paid to employee, salary, or other remuneration and does not include employer-provided retirement, medical or health care benefits, reimbursement for travel, meals, lodging, or any other expense.

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 uses the defined phrases “qualified employee” and “qualified employer”, to mean a “person or entity.” The terms "taxpayer" and "qualified taxpayer" are the customary terms used within a franchise or income tax credit statute to identify the entity eligible to claim and apply a tax credit against a tax liability. The author may wish to amend the bill to the terms “taxpayer” and “qualified taxpayer” for consistency in the tax credit statute.

The definition of “qualified industry” is very broad, and would allow an employer a tax credit on any recent undergraduate or graduate hired in the aerospace industry. If this is contrary to the author’s intention, this bill should be amended.

TECHNICAL CONSIDERATIONS

In subdivision (c) of Section 23623.2, the phrase “net tax,” as defined in Section 17039,” should be amended to “tax,” as defined in Section 23036.

LEGISLATIVE HISTORY

AB 927 (Muratsuchi, 2012/2013) would create a tax credit for an aerospace employer that hires certain new employees. AB 927 is currently set for hearing in the Assembly Revenue and Taxation Committee on May 8, 2013.

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 (drones). AB 1326 has been referred to the Assembly Revenue and Taxation Committee.

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

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

FISCAL IMPACT

This bill would require a calculation for the credit that could require new forms or worksheets to be developed. As a result, this bill could impact the department’s printing, processing, and storage costs for tax returns. The additional costs will be developed as the bill moves through the legislative process.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Estimated Revenue Impact of SB 414 As Introduced February 20, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
- $19	- $26	- $37

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 provide a tax credit for degrees earned within the state. In addition, this bill would include a larger percentage of wages in the calculation of the credit for degrees earned within the state. 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, etc., targeted tax credits such as the one proposed by this bill may be subject to constitutional challenge.

SUPPORT/OPPOSITION

Support: None identified.

Opposition: None identified.

ARGUMENTS

Proponents: Some could argue that this bill would stimulate job creation in the aeronautical industry by offering tax incentives to businesses that have the ability to employ new workers and expand their current workforce.

Opponents: Some taxpayers could argue that tax credits have less of an impact than predicted and cost more than anticipated. .

POLICY CONCERNS

This bill would allow taxpayers in certain circumstances to claim multiple tax credits for the same item of expense.

This bill would allow a credit for employee wages 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.

The tax credit calculation for tuition reimbursement would exclude private or other accredited national institutes from the limitation because the 50 percent limitation on the average annual tuition paid is based solely on graduates from the University of California or the California State of University. If this is contrary to the author's intention, this bill should be amended.

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