

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Hill Analyst: Brian Werking Bill Number: SB 434  
Related Bills: See Legislative History Telephone: 845-5103 Amended Date: April 1, 2013  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Enterprise Zone, LAMBRA, Manufacturing Enhancement Area, or Targeted Tax Area Employer Hiring Credit/Contingency Fee Penalty/FTB Disclosure of Taxpayer Information

### SUMMARY

This bill would do the following:

**Provision No. 1:** Prohibit contingency fees with respect to services rendered in connection with certain tax credits and provide a penalty for those contingency fee agreements.

**Provision No. 2:** Modify the existing Geographically Targeted Economic Development Area (Economic Development Area) hiring credits and requires the FTB to disclose taxpayer information on its website.

### RECOMMENDATION

No position.

### Summary of Amendments

The April 1, 2014, amendments replace non-substantive technical provisions related to the definition of "taxable year" with the two provisions discussed in this analysis.

This is the department's first analysis of the bill.

### REASON FOR THE BILL

The reason for the bill is to provide more effective tax incentives for economic growth and job creation in existing economic development locations.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The operative dates of the two provisions vary and are addressed separately for each provision.

Board Position:			
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Executive Officer	Date
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## **SUPPORT/OPPOSITION**

Support: California Labor Federation (sponsor).

Opposition: None identified.

## **PROVISION 1: Prohibit Certain Contingency Fee Agreements.**

### **EFFECTIVE/OPERATIVE DATE**

This provision would be specifically operative for all contracts or arrangements that provide for a fee for services rendered in connection with a tax credit relating to an enterprise zone, a LAMBRA, a manufacturing enhancement area, or a targeted tax area on or after the date of enactment. (See technical consideration below).

### **ANALYSIS**

#### **FEDERAL/STATE LAW**

Federal law allows the Secretary of the Treasury to regulate the practice of practitioners before the Internal Revenue Service (IRS). IRS Circular 230 generally spells out requirements for these practitioners, and also regulates the conduct of anyone providing tax advice or preparing tax returns for compensation, including attorneys, certified public accountants, and enrolled agents. In 2009, the IRS revised Circular 230 to bar individuals practicing before the IRS from charging clients contingency fees for services rendered in connection with any matter before the Internal Revenue Service, including the preparation or filing of a tax return, amended tax return or claim for refund or credit, with specified exceptions.<sup>1</sup>

State law restricts commissions charged by certified public accountants in specified circumstances.<sup>2</sup> State law does not conform to IRS Circular 230.

Under the Government Code, state law provides for several types of Economic Development Areas: 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 an Economic Development Area. These incentives include a hiring credit, sales or use tax credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within Economic Development Areas and a credit to taxpayers that are employees working in an EZ. The following table shows the incentives available to each of the Economic Development Areas.

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<sup>1</sup> The final regulations permit a practitioner to charge a contingent fee for services rendered in connection with the IRS examination of, or challenge, to (i) an original tax return, or (ii) an amended return or claim for refund or credit when the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return. Contingent fees are also permitted for interest and penalty reviews and for services rendered in connection with a judicial proceeding arising under the Internal Revenue Code. The final amendments to section 10.27 made by the final regulations apply to fee arrangements entered into after March 26, 2008.

<sup>2</sup> Business and Professions Code section 5061.

Types of Incentives	EZ	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	
Hiring Credit	X	X	X	X
Employee Wage Credit	X			
Business Expense Deduction	X	X	X	
Net Interest Deduction	X			
Net Operating Loss	X	X	X	

### THIS PROVISION

This provision would prohibit the use of contingent fees for services rendered in connection with a tax credit relating to an EZ, LAMBRA, MEA, or TTA and would authorize the FTB to impose a penalty equal to the greater of \$5,000 or 100 percent of the contingent fee charged for a violation of the prohibition. The penalty would be payable, upon notice and demand, regardless of whether any or all of the fee had been actually paid to or received, directly or indirectly, by the person subject to the penalty. The prohibition would not apply to services rendered in connection with the tax deduction incentives specific to an EZ, a LAMBRA, or a TTA.

The penalty imposed by the FTB for violating the prohibition against contingent fees would not be subject to protest or appeal prior to payment.

The FTB would be authorized to require a person rendering services in connection with a Economic Development Area tax credit to provide to the FTB upon request, written certification under penalty of perjury that the fee for their services does not include, in whole or in part, any contingent fee.

This provision would allow the FTB to prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this provision.

### 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.

Although this provision specifically states that Article 3 of Part 10.2 does not apply for purposes of assessing the penalty, it is unclear whether the author intends for the remainder of Part 10.2 to apply. To eliminate confusion among taxpayers, it is recommended that the author amend this provision to specify how this penalty should be implemented.

The prohibition against contingency fee agreements applies to agreements for services rendered in connection with a tax credit relating to an EZ, LAMBRA, MEA, or TTA. It is unclear for what is meant by "in connection with a tax credit." It is recommended that the author amend the bill to provide greater specificity.

This provision lacks an enforcement mechanism for failure to provide written certification upon the FTB's request. Without an enforcement mechanism, the certification requirement is merely suggestive. If that is contrary to the intent of the author, it is recommended that the bill be amended.

### TECHNICAL CONSIDERATIONS

On page 3, line 26, strikeout "the board of."

On page 3, line 36, after "tax area" and before "on" insert, "entered into."

### **LEGISLATIVE HISTORY**

SB 342 (Wolk, 2011/2012), would have prohibited contingent fee payment structures with regard to matters governed by the Revenue and Taxation Code. SB 342 failed to pass out of the Senate by the constitutional deadline.

### **FISCAL IMPACT**

This provision would require changes to the department's forms and information technology systems, and would require staff training. As a result, this bill would impact the department's costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

### **ECONOMIC IMPACT**

#### Revenue Estimate

Because of the deterrents contained in this provision, penalty revenue is expected to be minor. Some penalties would be assessed after enactment but would decline quickly in subsequent years as taxpayers and tax preparers become aware of the new law.

### **ARGUMENTS**

Proponents: Supporters of this provision may argue that prohibiting contingent fee arrangements would reduce the incentive to pursue overly aggressive positions with regard to certain tax matters.

Opponents: Some could argue that the structure of fee arrangements for professional tax services should be the decision of the parties involved and attorney's fees decisions are best left to the court, and neither should be dictated by the Legislature.

### **PROVISION 2: Modify the Existing Economic Development Area Hiring Credits and Require the FTB to Disclose Taxpayer Information on its Website.**

### **EFFECTIVE/OPERATIVE DATE**

These provisions would be specifically operative for taxable years beginning on or after January 1, 2013, and before January 1, 2019. The provisions authorizing these hiring credits would remain in effect only until December 1, 2019, and as of that date would be repealed.

## **ANALYSIS**

### FEDERAL/STATE LAW – Hiring Credits

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.

Under the Government Code, state law provides for several types of Economic Development Areas: EZs, MEAs, TTAs, and LAMBRAs. Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within an Economic Development Area, including a hiring credit.

Under the Revenue and Taxation Code, a business located in an Economic Development Area may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an Economic Development Area 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 Economic Development Area and at least 50 percent must be performed inside the Economic Development Area. The business may claim up to 50 percent of the wages paid to a qualified employee as a credit against tax imposed on income from a trade or business operating within an Economic Development Area.

The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current state 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. Certain criteria regarding who may be a qualified employee and certain limitations differ between the various Economic Development Areas.

Taxpayers operating in Economic Development Areas are allowed the hiring credit for employing "qualified employees." "Qualified employees" are defined by reference to various state and federal public assistance programs. The categories of individuals considered qualified employees are substantially similar but not identical. A taxpayer located in an Economic Development Area is allowed a credit of up to 50 percent of wages paid to "qualified employees" in the first year, decreasing by 10 percent each year thereafter. The taxpayer is required to obtain a voucher certificate for each of its "qualified employees." The voucher certificates are issued by the Employment Development Department (EDD) or the local (within the same Economic Development Area as the workplace of the employee) agency familiar with the public assistance statutes. The voucher is required to be retained by the qualified taxpayer in order for the certification to be made available to the FTB upon request.

The Economic Development Area hiring credits do not have an annual aggregate cap or a sunset date

### **STATE LAW – Disclose Taxpayer Information**

Current state law prohibits the disclosure of a taxpayer's return and return information, except as specifically authorized by statute. Generally, disclosure is authorized to other state tax agencies and federal tax agencies for tax administration purposes only.

Existing state law requires the FTB to compile and make publicly available, at least twice per year, a list that identifies the Top 500 tax delinquencies that exceed \$100,000, selected from both the Personal Income Tax and Corporation Tax records. For purposes of the Top 500 list, a tax delinquency is defined as the total amount owed by a taxpayer to the State of California for which a Notice of State Tax Lien has been recorded in any county recorder's office in the state.

Existing law requires the FTB to periodically provide notice on its Web site with respect to the amount of the New Jobs Tax Credit<sup>3</sup> claimed on timely filed income tax returns.

### **THIS PROVISION**

#### **Hiring Credit**

This provision would modify the percentages that would be used to calculate the Economic Development Area hiring credit over the five year credit period from the existing 10/20/30/40/50 percentages to a 10/10/30/40/50 scheme.

The Economic Development Area hiring credit would only be available for qualified wages paid for each net increase in qualified employees. If a qualified taxpayer relocates to a TTA from another location within the state, hiring credits would only be available if each employee at the previous location or locations is provided a bona fide offer of employment at the new location.

This provision would modify the definition of "qualified wages" by providing that the credit would be based on the portion of wages paid that exceeds 200 percent of the minimum wage and does not exceed 500 percent of minimum wage.

Employers that provide temporary help services, as described in Code 561320 of the North American Industry Classification System, would be specifically precluded from receiving an Economic Development Area hiring credit.

The qualified taxpayer would be required to provide to the FTB on an annual basis, the voucher certificates for each of the taxpayer's qualified employees.

This provision would establish an aggregate cap for each of the Economic Development Area hiring credits, except for the EZ hiring credit. The cap would be based on the aggregate amount of the specific hiring credit claimed for the 2012 taxable year. The FTB would be required to allocate the aggregate amount of the LAMBRA, TTA, and MEA hiring credits upon receipt of a timely filed original return on a first-come-first-serve basis.

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<sup>3</sup> As provided under Revenue and Taxation Code Section 17053.80 and 23623.

Economic Development Area hiring credits would not be available for taxable years beginning on or after January 1, 2019.

### Disclose Taxpayer Information

This provision would require the FTB to compile voucher certifications received from taxpayers and produce on its Web site, a searchable database containing the names of the employers, amounts of tax credit claimed, and the number of new jobs created, for all Economic Development Area hiring credits.

### 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.

The calculation for the net increase in qualified employees could result in treating a net decrease as a net increase and preclude the credit from being available when there is an increase in the qualified workforce. If this is contrary to the author's intent, the bill should be amended.

Taxpayers purchasing businesses within Economic Development Area locations would be able to include those newly acquired employees within the calculation for the net increase in qualified employees. If this is contrary to the author's intent, the bill should be amended.

It is unclear how the calculation of the net increase in qualified employees would be applied to individual employees from year to year for each of their first five years of employment for which a credit could be available. Would a net increase be required each year? It is recommended that the author amend the bill to specify how to measure the net increase from year to year.

The Economic Development Area hiring credits would be unavailable to an otherwise qualifying employer that moves to a TTA from another location within the state unless the qualifying employer makes a "bona fide" offer of employment in the new location to each existing employee. It is unclear what would constitute a "bona fide" offer. Additionally, if it is the author's intent for all moves to any Economic Development Area to be subject to the "bona fide" offer requirement, this bill should be amended.

The EZ hiring credit does not have a cap, whereas the other hiring credits have a cap based on the aggregate amount claimed for the 2012 taxable year. Is the EZ hiring credit intended to be excluded from having the cap requirement? Also, the caps set for the other (non EZ) hiring credits are based on the aggregate amounts claimed for the 2012 taxable year and the data to determine the cap would be unavailable before some 2013 tax returns would be due, leading to uncertainty on the total available credit.

The credits claimed for the 2012 taxable year on amended returns in future years would continuously alter the credit cap applied to non EZ hiring credits. If this is not the author's intent, the author may wish to amend the bill to base the credit cap on the aggregate amount of credits claimed on timely filed original returns.

The first-come-first-serve method of allowing the capped credits would result in taxpayer uncertainty on whether a credit would be ultimately allowed. For example, if, on the day the cap is reached, there is only enough credits for 50 taxpayers, but there are 100 timely filed returns claiming the credit, which 50 would ultimately be allowed the credit? In this scenario a taxpayer that timely files a return could no longer be certain that they would receive the credit they claimed.

Because the bill fails to specify otherwise, the FTB would be subject to the rulemaking procedures required under the Administrative Procedures Act (APA). Following these procedures may delay and complicate the implementation of this bill. It is recommended that the author add a provision exempting the FTB from the APA when the FTB is prescribing rules, guideline, or procedures necessary or appropriate to carry out the purpose of this bill.

This provision would require confidential taxpayer information to be disclosed on the FTB's public Web site. It is unclear if the author's intent is for the FTB to make public, taxpayer information that would normally be considered confidential taxpayer information. If this is the author's intent, the bill should be amended to provide the FTB with specific disclosure authorization.

This provision would require the FTB to provide on its Web site the number of jobs created for G-TEDA hiring credits. It is unclear how the number of jobs created would be calculated from year to year.

## **LEGISLATIVE HISTORY**

AB 9 (Holden, 2013/2014), would modify the definition of the "qualified wages" and "qualified employee" for purposes of the EZ Hiring Credit. This bill is set to be heard in the Assembly Jobs, Economic Development and Economy Committee on April 29, 2013.

AB 28 (Perez, 2013/2014), would modify the rules relating to EZ boundaries and expand the FTB's reporting requirements under the EZ Act. AB 28 is set to be heard in the Assembly Jobs, Economic Development and Economy Committee on April 29, 2013.

AB 231 (Perez, 2011/2012), among other things, would have modified the definition of qualified wages within the EZ Hiring Credit to allow a greater portion of wages above the minimum wage to be used to calculate the credit and would have modified the definition of "qualified employee" to include additional categories of individuals. AB 231 failed to pass out of the Assembly by the constitutional deadline.

AB 2439 (Eng, 2011/2012), among other things, would have required the FTB to annually publish, a list of the 500 largest corporate taxpayers and include the tax liability and charitable contributions of each corporate taxpayer on the list, and whether each corporate taxpayer elected to utilize the single sales factor apportionment formula. AB 2439 failed to pass out of the Senate by the constitutional deadline.

AB 1139 (Perez, 2009/2010), among other things, would have modified the definition of qualified wages within the EZ Hiring Credit to require a portion of an employee's healthcare be paid by the employer before that employee's wages would be considered qualified wages. AB 1139 failed to pass out of the Assembly by the constitutional deadline.

SBX3 15 (Calderon, Chapter 17, Statutes of 2009), among other things, requires the FTB to provide periodic notice on its website of the amount of the New Jobs Tax Credit claimed on timely filed original returns.

## **FISCAL IMPACT**

Department staff is unable to determine the costs to administer this provision until the implementation concerns have been resolved. In addition, this provision would require manual keying of certification data as well as the creation of a searchable database. As a result, this bill would impact the department's processing and information technology costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

## **ECONOMIC IMPACT**

### Revenue Estimate

Although this provision would result in revenue gains relative to current law, department staff are unable to quantify the gains because the provision appears to be internally inconsistent in that it requires an increase in total number of employees in order for hiring credits to be claimed, but the method of calculating the credits would preclude taxpayers who increase the total number of employees from being eligible for the credit.

## **POLICY CONCERNS**

California's tax system primarily relies on the taxpayer to self-assess and pay the proper amount of tax due. If tax payment information is disclosed to the public, it is unclear what impact, if any, there may be on the self-assessment tax system.

## **ARGUMENTS**

**Proponents:** Supporters could argue that this provision would provide an incentive for taxpayers to increase the wages paid to employees within G-TEDA locations and would provide economic growth in Economic Development Area locations.

**Opponents:** Some could say that providing an additional wage limitation in order to receive the Economic Development Area hiring credits would reduce the credit's incentive to encourage employers to hire new employees, resulting in less economic growth within Economic Development Area locations.

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