

ANALYSIS OF ORIGINAL BILL

Author: Hueso Analyst: Jessica Deitchman Bill Number: SB 1216
See Legislative
Related Bills: History Telephone: 845-6310 Introduced Date: February 18, 2016
Attorney: Bruce Langston Sponsor _____

SUBJECT: Employer Hiring Credit/FTB to Provide JLBC Annually Report of Total Dollar Amount of Credit Claimed

SUMMARY

This bill would under the Personal Income Tax Laws (PITL) and the Corporation Tax Law (CTL) provide a tax credit for employers that hire certain ex-offenders who have completed a work readiness program.

RECOMMENDATION

No position.

Summary of Suggested Amendments

Technical amendments are suggested below for clarity and to correct grammatical and spelling errors.

REASON FOR THE BILL

The reason for the bill is to encourage employers to hire employees between the ages of 18-25 who have a criminal conviction and have completed a work readiness program through a qualified job training program.

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, 2016, and before January 1, 2021.

FEDERAL/STATE LAW

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

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 state law allows a New Employment 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 tract or former Enterprise Zone. The qualified taxpayer must receive a tentative credit reservation from the Franchise Tax Board (FTB) for that qualified full-time employee.

THIS BILL

For taxable years beginning on or after January 1, 2016, and before January 1, 2021, this bill would allow a credit to a qualified taxpayer equal to 20 percent of the qualified wages paid or incurred to a qualified full-time employee. The credit could not exceed \$15,000 per qualified taxpayer per taxable year.

A “qualified full-time employee” would mean an individual who meets all of the following requirements:

- Receives starting wages that are at least 150 percent of the minimum wage.
- Is hired by the qualified taxpayer on or after January 1, 2016.
- Satisfies either of the following conditions:
 - Is paid qualified wage by the qualified taxpayer for services not less than an average of 35 hours per week.
 - Is a salaried employee and was paid compensation during the taxable year for full-time employment by the qualified taxpayer.
- Is an ex-offender previously convicted of a felony who:
 - Is at the time of hiring between 18 and 25 years of age, and
 - Who demonstrates completion of a work readiness program.

“Work readiness program” would mean a program offered by a job training provider that provides vocational job training, education opportunities, and life skills. A work readiness program would include all of the following:

- Paid or unpaid on-the-job training opportunities, pre-apprenticeship programs, vocational instruction or internship placement.
- The opportunity for academic advancement.
- The opportunity to earn at least one industry recognized certification.
- A life-skills training component.

An individual may be considered a qualified full-time employee only for the period of time commencing with the date the individual is first employed by the qualified taxpayer and ending 60 months thereafter.

“Qualified taxpayer” would mean a person or entity engaged in a trade or business within the state that, during the taxable year, pays or incurs qualified wages.

- In the case of a pass-thru entity, the determination of whether a taxpayer is a qualified taxpayer would be made at the entity level and any credit would be allowed to the pass-thru entity and pass through to the partners and shareholders.¹
 - The term “pass-thru entity” means any partnership or “S” corporation

“Qualified taxpayer” would not include any of the following types of employers, as specified in specific North American Industry Classification System (NAICS) codes:

- Employers that provide temporary help services.
- Employers that provide retail trade services.
- Employers that are primarily engaged in providing food services.
- Employers that are primarily engaged in services in casinos, casino hotels, or drinking places.
- Employers that are a “sexually oriented business” as defined.

“Qualified wages” means those wages that meet all of the following requirements:

- That portion of wages paid or incurred by the qualified taxpayer during the taxable year to each qualified full-time employee that exceeds 150 percent of minimum wage, but does not exceed 350 percent of minimum wage.
- Wages paid or incurred during the 60-month period beginning with the first day the qualified full-time employee commences employment with the qualified taxpayer.
 - In the case of any employee who is reemployed, including a regularly occurring seasonal increase, in the trade or business operations of the qualified taxpayer, this reemployment would not be treated as constituting commencement of employment.

The bill would also define the terms “acquire,” “minimum wage,” “seasonal employment,” and “job training provider.”

To be eligible for the credit, a qualified taxpayer would upon hiring a qualified full-time employee, request a tentative credit reservation from the FTB within 30 days of complying with the Employment Development Department’s (EDD) new hiring reporting requirements,² in the form and manner prescribed by the FTB.

To obtain a tentative credit reservation with respect to a “qualified full-time employee, the qualified taxpayer would provide necessary information, as determined by FTB. The qualified taxpayer would provide the FTB with an annual certification of employment for each qualified full-

¹ In accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

² Provided in Section 1088.5 of the Unemployment Insurance Code.

time employee hired in a previous taxable year.³ The reservation and the certification would include:

- Name
- Social security number
- Start date of employment
- Rate of pay of the qualified full-time employee.

A tentative credit reservation provided to a taxpayer with respect to an employee would not constitute a determination by the FTB regarding a taxpayer's eligibility for the credit.

The FTB would do all of the following:

- Approve a tentative credit reservation with respect to a qualified full-time employee hired during a calendar year,
- Determine the aggregate tentative reservation amount, and
- Provide a searchable database on its Internet Web site for each taxable year beginning on or after January 1, 2016 and before January 1, 2021, that includes the following for each taxable year:
 - The employer names,
 - Amounts of tax credit claimed, and
 - The number of new jobs created.

The credit could only be claimed on a timely filed original return and only with respect to a qualified full-time employee for whom the qualified taxpayer has received a tentative credit reservation.

All employees of the trades or businesses that are not incorporated and that are under common control would be treated as employed by a single taxpayer.

The credit with respect to each trade or business would be determined by reference to its proportionate share of the expense of the qualified wages giving rise to the credit and would be allocated to that trade or business in that manner.

If an employer acquires the major portion of a trade or business of another employer, hereinafter referred to as the predecessor, or the major portion of a separate unite of a trade or business of a predecessor after that acquisition, the employment relationship between a qualified full-time employee and employer would not be treated as terminated if the employee continues to be employed in that trade or business.

³ On or before the 15th day of the third month of the taxable year.

The bill defines “controlled group of corporations” as a controlled group of corporations as defined in Section 1563(a) of the Internal Revenue Code (IRC) except that:

- More than “50 percent” shall be substituted with “at least 80 percent.”⁴
- The determination would be made without regard to subsections (a)(4)⁵ and (e)(3)(C)⁶ of Section 1563 of the IRC.

If the employment of any qualified full-time employee,⁷ is terminated by the qualified taxpayer at any time during the first 36 months after commencing employment with the qualified taxpayer, whether or not consecutive, the tax for the taxable year in which that employment is terminated would be increased by an amount equal to the credit allowed for that taxable year and all prior taxable years attributable to qualified wages paid or incurred with respect to that employee. This recapture provision would not apply to any of the following conditions:

- A termination of employment of a qualified full-time employee who voluntarily leaves the employment of the qualified taxpayer.
- A termination of employment of a qualified full-time employee who, before the close 36 months of employment, becomes disabled and unable to perform the services of that employment, unless that disability is removed before the close of the 36 months and the qualified taxpayer fails to offer reemployment to that employee.
- A termination of employment of a qualified full-time employee if it is determined that the termination was due to the misconduct⁸ of that employee.
- A termination of employment of a qualified full-time employee due to a substantial reduction in the trade or business operations of the qualified taxpayer, including reductions due to seasonal employment.
- A termination of employment of the qualified full-time employee when that employee is replaced by other qualified full-time employees so as to create a new increase in both the number of employees and the hours of employment.
- A termination of the employment of the qualified full-time employee when that employment is considered seasonal employment and the qualified employee is rehired on a seasonal basis.

The employment relationship between the qualified taxpayer and a qualified full-time employee would not be treated as terminated by reason of a mere change in the form and conducting the trade or business of the qualified taxpayer if the qualified full-time employee continues to be employed in the trade of business that the qualified taxpayer retains substantial interest in that trade or business.

⁴ Each place it appears in Section 1563(a) of the IRC.

⁵ Related to insurance companies.

⁶ Related to estates and trusts.

⁷ With respect to whose qualified wages are taken into account for purposes of calculating the credit.

⁸ As defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations.

In the case of an estate or trust, both of the following apply:

- The qualified wages for a taxable year would be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each.
- A beneficiary, to whom any qualified wages have been apportioned, would be treated as the employer with respect to those wages.

Any excess credit may be carried over to reduce the net tax/tax for the succeeding 5 years, if necessary until the credit is exhausted.

The FTB may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this credit, including any guidelines regarding the allocation of the credit allowed. Section 3.5 of part 1 of Division 3 of Title 2 of the Government Code would not apply to any rule, guideline, or procedure prescribed by the FTB pursuant to this section.

The FTB would annually provide to the Joint Legislative Budget Committee, no later than March 1, a report of the total dollar amount of the credits claimed with respect to the relevant fiscal year. The report would compare the total dollar amounts of credit claimed, with respect to that fiscal year with the departments estimate with respect for that same fiscal year. If the total dollar amount of credits claimed for the fiscal year is less than the estimate for that fiscal year, the report would identify options for increasing annual claims of the credit so as to meet estimated amounts.

Section 41 would not apply to the credit allowed by this section.

This credit would remain in effect only until December 1, 2021, and as of that date would be repealed.

IMPLEMENTATION CONSIDERATIONS

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

For taxable years beginning on or after January 1, 2016, the bill would allow a qualified employer that hires qualified employees a credit for wages paid to those qualified employees, but only if the employer receives a tentative credit reservation from the FTB within 30 days of complying with the EDD's new hire reporting requirements. Because of this requirement, any employer that hires qualified employees between January 1, 2016, and the date this bill is enacted (presumably after September of 2016) would be ineligible for the credit because they would have failed to meet this requirement. If this is contrary to the author's intent, the bill should be amended to either revise the operative date to January 1, 2017, or remove the reservation requirement.

TECHNICAL CONSIDERATIONS

Department staff has identified the following technical considerations. 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 phrase “net tax”, however, “tax” is the customary phrase used within the CTL. For consistency and harmony with other tax credit language it is recommended that this bill be amended to reference the correct phrase.

Because an S-corporation is not a pass-thru entity for CTL purposes, the term “S-Corporation” should be deleted in the CTL portion of the bill.

LEGISLATIVE HISTORY

AB 1404 (Grove, 2015/2016) would have allowed a credit to a qualified employer who employs a qualified employee and pays the qualified employee a wage that exceeds the minimum wage during the taxable year. The credit would be in an amount equal for the difference between the special minimum wage that may be paid to a qualified employee and the minimum wage. AB 1404 failed to pass out of the house of origin by the constitutional deadline.

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 PITL and CTL, created a New Hiring Tax Credit, established the California Competes Tax Credit Committee, and created the California Competes Tax Credit under the PITL and CTL.

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

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1216 As Introduced February 18, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$0.6	- \$1.6	- \$2.3

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

Revenue Discussion

Based on industry and government data, it was estimated there were approximately 35,000 ex-offenders previously convicted of a felony in California between the ages of 18 and 25 years in 2016. Using research studies on re-entry programs, it was assumed that 30 percent, or approximately 10,000, of these individuals entered a qualified work readiness program. It was further assumed that 30 percent, or 3,200, of these ex-felons subsequently found employment. This was reduced by 75 percent to adjust for employment in non-qualified industries, part-time employment and jobs with wages below 150 percent of minimum wage. This results in approximately 800 qualified full time employees in the 2016 taxable year. Based on FTB tax data for the existing New Employment Credit (NEC), the average credit per employee is estimated at approximately \$2,000 in 2016.

Based upon the initial experience with NEC, FTB estimates 50 percent of qualified employers would receive tentative credit reservations in 2016 increasing to 70 percent in 2020. Because the employer must receive a tentative credit reservation to be eligible for the credit, an estimated 100 employees hired would qualify for the credit in the 2016 taxable year generating \$200,000 in available credits (800 x 50% x 25% x \$2,000). The number of eligible employees increases to approximately 800 in the 2017 taxable year and 2,000 employees in the 2020 taxable year once fully phased in. This results in credits generated of \$1.6 million in the 2017 taxable year increasing to \$4.2 million in the 2020 taxable year.

It was assumed that 70 percent of the credit would be used in the year generated and the remaining amount would be carried forward to future years. This results in credits claimed of \$150 thousand in the 2016 taxable year, \$1.2 million in the 2017 taxable year, increasing to \$3.7 million in the 2020 taxable year. It was assumed that 80 percent would be claimed by corporations and 20 percent would be claimed by personal income taxpayers.

The tax year estimates were converted to fiscal year, and rounded to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION⁹

Support: California Association of Local Conservation Corps.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would encourage hiring of underprivileged employees by offering a tax credit to employers.

Opponents: Some may argue that this credit is overly narrow and inadvertently excludes other groups of employees who could benefit from an incentive being offered to employers that hire these employees.

POLICY CONCERNS

This bill would allow a credit for wages paid to a qualified employee 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.

This bill would allow taxpayers in certain circumstances, to claim multiple tax credit benefits for the same wages paid.

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⁹ As noted on the staffer provided fact sheet.