

ANALYSIS OF ORIGINAL BILL

Author: Runner Analyst: Diane Deatherage Bill Number: SB 1272
See Legislative
Related Bills: History Telephone: 845-4783 Introduced Date: February 18, 2016
Attorney: Bruce Langston Sponsor _____

SUBJECT: Small Business Employer Contributions to Employee Savings Plan Credit/FTB
Provide Report to Legislature by January 1, 2018

SUMMARY

This bill would allow a tax credit, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), for certain small businesses.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to create tax incentives for participating small businesses by providing a partial tax credit for matching amounts contributed to an employee's savings account.

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**Credits Generally**

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.

Federal and state laws lack a credit comparable to the credit this bill would allow.

Under California Revenue and Taxation Code (R&TC) section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the credit's effectiveness.

THIS BILL

Under the PITL and CTL, for taxable years beginning on or after January 1, 2016, and before January 1, 2021, a qualified taxpayer would be allowed a tax credit in an amount equal to 50 percent of that qualified taxpayer's contributions to a qualified employee saving plan, not to exceed \$2,000 per employee per taxable year.

“Qualified employee savings plan” would mean an employee savings plan where at least half of the recipient employees earn less than \$40,000 in wages received from the qualified taxpayer per taxable year.

“Qualified taxpayer” would mean a taxpayer that is a small business as defined in the Government Code.¹

This bill would require that the FTB annually prepare a written report to the Legislature that contains the following information:

- The percentage of employees under 30 years of age who are receiving matching funds.
- The percentage of employees earning less than \$40,000 per annum who are receiving matching funds.

The first report to the Legislature would be due on or before January 1, 2018 and each January 1 thereafter.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill would define “small business” by reference to section 14837 of the Government Code. This definition includes phrases and terms, i.e., “small business,” “affiliates,” “average annual gross receipts,” “year,” and “manufacturer” that are undefined, or whose definitions are in conflict with definitions found in the R&TC or the Internal Revenue Code. The absence of specific definitions to clarify these terms could lead to disputes between the department and taxpayers and would complicate the administration of this bill.

It is unclear how the amount of credit would be determined or limited for entities in combined groups, as well as how the number of employees should be computed when determining if a business would be considered a small business. The bill should be amended to clarify how the credit should be determined and how the number of employees should be computed.

It is unclear whether the \$2,000 limitation applies to the taxpayer's total amount of allowable credit or the taxpayer's total amount of contributions made to the employee's account. The author may wish to amend this bill to clarify how the limit would be applied.

¹ [Government Code section 14837](#) defines “small business” as an independently owned and operated business that is not dominant in its field of operation, the principal office of which is located in California, the officers of which are domiciled in California, and which, together with affiliates, has 100 or fewer employees, and average annual gross receipts of ten million dollars (\$10,000,000) or less over the previous three years, or is a manufacturer, as defined in subdivision (c), with 100 or fewer employees.

The bill lacks language regarding the oversight necessary to administer this credit. Would the employee have any restrictions on how the money could be used? How long must the money remain in a savings account (one day?)? Who would verify the employees are meeting these requirements? The bill should be amended to include specifics on how the savings account would work.

Wages paid for services rendered outside the state would be eligible for the credit. If this is contrary to the author's intent, the bill should be amended.

LEGISLATIVE HISTORY

SB 594 (Ashburn, 2009/2010) would have established, under both the PITL and the CTL, a credit against income or franchise tax in the amount of 15 percent of administrative costs incurred by a qualified taxpayer in connection with establishing or administering a cafeteria plan that provides for the payment of health insurance premiums of the taxpayer's employees.

SB 820 (Ashburn, 2007/2008) & SBX1 23 (Ashburn, 2007/2008) contained provisions similar to SB 594 (2009/2010). SB 820 failed to pass out of the Senate Revenue and Taxation Committee by the constitutional deadline. SBX1 23 failed passage in the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. None of these states provides a credit comparable to the credit this bill would allow.

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 1272 As Introduced on February 18, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$8.9	- \$7.5	- \$7.8

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 data from the U.S. Small Business Administration, it is estimated that there were approximately 680,000 small businesses in California in 2014. Grown to 2016, this becomes 700,000 small businesses. Research indicates that 60 percent of these businesses would pay at least half their employees less than \$40,000 in wages per year. Using FTB data, it is estimated that 90 percent of small businesses have annual gross receipts of less than \$10 million. Therefore, it is assumed that 375,000 small businesses would qualify for this credit.

Based on data from the U.S. Government Accountability Office, an average of 15 percent of small businesses sponsor some type of retirement plans. This amount was applied to the small businesses that would qualify for the credit. It is assumed that 15 percent, or 8,500, of these small businesses would be solvent and choose to contribute to an employee's savings plan. Based on data from the U.S. Small Business Administration, it is estimated that on average there are six employees per small business. Therefore, it is assumed there would be approximately 51,000 employees for whom the employer would make contributions on their behalf. However, in the first year this was reduced by 25 percent to account for the timing of enactment and employers having enough time to make timely contributions to employee retirement savings accounts.

It is assumed that small businesses would contribute between \$250 and \$1,000 per year per employee. After multiplying the assumed contribution amounts by the estimated number of employees, the total estimated qualified contributions would be \$15 million in 2016. The credit generated would be 50 percent of qualified contributions, resulting in an estimated \$7.5 million in credit generated. The amount of credit that each taxpayer could use would be limited by the taxpayer's current year tax liability. The estimate assumes 75 percent, or \$5.6 million, of the credit generated would be used in the year generated and the remaining credit would go unused, as the bill lacks carryover language.

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill would encourage savings by employees and may also benefit employers as this incentive may attract employees.

Opponents: Some may argue that this bill may not encourage an individual to save as the money could be immediately withdrawn.

POLICY CONCERNS

This bill would allow a credit for employer contributions to the employee's savings account that may also be 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 lacks carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year allowed. The author may wish to add language allowing a limited carryover period.

LEGISLATIVE STAFF CONTACT

Diane Deatherage
Legislative Analyst, FTB
(916) 845-4783
diane.deatherage@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov