

- At least half of the participating employees earn less than \$40,000 in wages during the calendar year for work performed for the employer contributing to the plan.
- Deposits held in an insured bank or other financial institution are subject to withdrawal by employees.
- Any employee who withdraws funds from an Employee Saving Match Plan less than one year after the employee's first contribution or less than one year after a previous withdrawal shall not be eligible to participate in that plan for the remainder of the year in which that withdrawal was made or during the next calendar year. A transfer of funds from an Employee Savings Match Plan into an IRA or other deferred compensation plan shall not be considered a withdrawal.

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

Contributions to, and income from, an Employee Savings Match Plan would be treated as ordinary income.

The bill would allow any unused credit to be carried forward for four years.

On or before January 1, 2018, and each January 1 thereafter, the Franchise Tax Board (FTB) would be required to report annually to the Legislature (1) the percentage of employees under 30 years of age who are receiving matching funds, and (2) the percentage of employees earning less than \$40,000 per annum who are receiving matching funds.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional considerations 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 considerations 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 would be 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.

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 \$10,000,000 or less over the previous three years, or is a manufacturer, as defined in subdivision (c), with 100 or fewer employees.

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 would be computed when determining if a business would be considered a small business. The bill should be amended to clarify how the credit would be determined and how the number of employees would be computed.

It is unclear whether the \$2,000 limitation would apply 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.

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? Is limitation on withdrawal only for the employer match or for both the employee contribution and employer match? What if there is no employer match – could an employee withdraw their funds immediately? 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.

The bill uses “employer” and “qualified taxpayer” interchangeably. The absence of consistency could lead to disputes between the department and taxpayers and would complicate the administration of this bill.

The definition of “Employee Savings Match Plan” lacks clarity; for example, it is unclear how to apply the \$12,000 annual salary condition to hourly employees, as well as how to determine if a qualified taxpayer meets all of the conditions, if one of the conditions would be elective and not mandatory (i.e., “employer may match voluntary contributions of participating employees. . .”). The bill should be amended to clarify the definition to reduce confusion.

TECHNICAL CONSIDERATIONS

“Contributions” should be identified as “matching contributions” where appropriate and “matching contributions” should be defined within the bill to clarify which contributions made by a qualified taxpayer would qualify for this credit.

The bill uses the unspecified acronym “IRA.” For consistency and clarity, the acronym should be replaced with the phrase “individual retirement account.”

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 Amended April 12, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$9.3	- \$9.0	- \$9.6

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. The number of small businesses is adjusted to reflect changes in the economy over time and is estimated to increase to 700,000 small businesses in 2016. It is assumed that 55 percent, or approximately 385,000 ($\approx 700,000 * 55$ percent) of these businesses would pay at least half their employees less than \$40,000 but more than \$12,000 in wages per year. Using FTB data, it is estimated that 90 percent of small business have annual gross receipts of less than \$10 million. Therefore, it is assumed that approximately 345,000 ($\approx 385,000 * 90$ percent) small businesses would qualify for the credit.

Based on data from the U.S. Government Accountability Office, an average of 15 percent, or approximately 52,000 ($\approx 345,000 * 15$ percent) small businesses sponsor some type of retirement plan. It is assumed that 15 percent, or approximately 7,800 ($\approx 52,000 * 15$ percent), of these small businesses would be solvent and choose to contribute to an Employee Savings Match 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 47,000 ($\approx 7,800 * 6$) employees for whom the employer would make contributions on their behalf. However, in the first year, this is reduced by 25 percent to account for the timing of enactment and employers having enough time to make timely contributions to an Employee Savings Match Plan.

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 \$14 million in 2016. The credit generated would be 50 percent of qualified contributions, resulting in an estimated available credit of \$7 million. Because the amount of credit that each qualified taxpayer could use would be limited to the qualified taxpayer's current year tax liability, the estimate assumes 75 percent, or \$5 million, of the credit generated would be used in the year generated and the remaining credit would be carried over and used within the next two years.

In addition to the credit, a qualified taxpayer would be allowed a deduction for contributions to Employee Savings Match Plans, as they would be treated as ordinary and necessary expenses. The estimated contributions of \$14 million are multiplied by an average tax rate of 6 percent, resulting in an estimated revenue loss of \$840,000. The estimated revenue loss is offset by the income tax the employee would pay on contribution income received from the plan. An estimated average tax rate of 4 percent is applied, resulting in an estimated revenue gain of \$560,000. This results in an estimated net revenue loss of \$280,000 (\$560,000 - \$840,000). This loss is added to the revenue loss from the credit for a total estimated loss of \$5.3 million (\$5 million + \$280,000) in 2016.

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.

POLICY CONCERNS

This bill would allow a qualified taxpayer a credit for employer contributions to the employee's Employee Savings Match Plan that would 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.

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