

SUMMARY ANALYSIS OF AMENDED BILL

Author: Runner Analyst: Diane Deatherage Bill Number: SB 1272
Related Bills: See Prior Telephone: 845-4783 Amended Date May 4, 2016
Analysis Attorney: Bruce Langston Sponsor: _____

SUBJECT: Small Business Employer Contributions to Employee Savings Match 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.

SUMMARY OF AMENDMENTS

The May 4, 2016, amendments added clarifying language, defined new terms, modified existing terms, revised the repeal date, and made various technical changes.

The amendments resolved all of the implementation considerations and policy concerns discussed in the department’s analysis of the bill as amended on April 12, 2016, and an additional five technical considerations and two implementation considerations were identified.

Except for the “This Bill,” “Technical Considerations,” “Implementation Considerations,” “Economic Impact,” and “Policy Concerns” sections, the remainder of the department’s analysis of the bill as amended on April 12, 2016, still applies. The “Fiscal Impact” and “Support/Opposition” sections have been restated below for convenience.

THIS BILL

Under the PITL and CTL, for each taxable year 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 the qualified taxpayer’s dollar-for-dollar matching contributions to the account of an eligible employee’s Employee Savings Match Plan up to \$2,000 per employee per taxable year. The maximum amount of credit allowed under this credit would be \$1,000. The bill would allow any unused credit to be carried forward for four years.

“Employee Savings Match Plan” would mean a savings plan established by a qualified taxpayer that meets all of the following:

- A qualified taxpayer may match, on a dollar-for-dollar basis, the voluntary contributions of participating employees, as specified, without limitation. However, contributions in excess of \$2,000 per employee per taxable year would be ineligible for a credit under this bill.
- Any employee who has California wages subject to income tax withholding under Division 6 of the Unemployment Insurance Code and has been continuously employed by the qualified taxpayer for at least six months may participate in and contribute to an Employee Savings Match Plan.
- At least one-half of the participating employees earn less than \$40,000 during the taxable year in wages subject to income tax withholding under Division 6 of the Unemployment Insurance Code for work performed for the employer contributing to the Employee Savings Match Plan.
- Contributions are held in an insured bank or other financial institutions in individual accounts as separate property of each participating employee and may be withdrawn by employees, as provided.
- If an employee withdraws funds from an Employee Savings Match Plan less than 12 months after the employee’s first contribution, or less than 12 months after a previous withdrawal, other than a qualified withdrawal, then a qualified taxpayer is ineligible for a credit for any matching contributions made with respect to contributions made by that employee during the remainder of the taxable year in which the withdrawal was made or the next taxable year.

The bill would define certain terms, including, but not limited to:

- “Matching contributions” would mean any contributions made by a qualified taxpayer for the benefit of employees which are eligible to be taken into account for purposes of computing this credit.
- “Qualified taxpayer” would mean a taxpayer that, for the taxable year for which a credit is allowed, satisfies both of the following conditions:
 - Has gross receipts, less returns and allowances, derived from or reportable to this state, for the taxable year of \$10,000,000 or less.
 - “Gross receipts, less returns and allowances, reportable to this state” would mean the sum of gross receipts from the production of business income¹ and the gross receipts from the production of nonbusiness income.²

¹ As defined in Revenue and Taxation Code (R&TC) section 25120(a).

² As defined in R&TC section 25120(d).

- “Gross receipts, less returns and allowances reportable to this state” would be determined using the rules for assigning sales³ to this state and the regulations thereunder, as modified by the alternate apportionment regulation,⁴ other than those provisions that exclude receipts from the sales factor.
 - Has fewer than 100 employees at any time during the taxable year.
- “Qualified withdrawal” would mean a withdrawal from an Employee Savings Match Plan during a taxable year which does not exceed the amount the employee contributed to a qualified retirement plan⁵ or a Secure Choice account⁶ during the same taxable year.

The credit must be claimed on a timely filed original return.

The qualified taxpayer would annually report the social security number and account information for each employee participating in and contributing to the Employee Savings Match Plan in the form and manner prescribed by the Franchise Tax Board (FTB).

The credit would be in lieu of any other credit or deduction with respect to the matching contributions of a qualified taxpayer that would be taken into account in computing the credit allowed as proposed in this bill.

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 taxable year who are receiving matching contributions.

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

The bill authorizes the FTB to prescribe rules, guidelines, procedures, or regulations necessary or appropriate to carry out the purposes of this bill.

This credit would be repealed by its own terms as of December 1, 2022.

TECHNICAL CONSIDERATIONS

The language is unclear as to the limitation of the credit amount. Without clarification, the language could be interpreted to be limited to \$1,000 per qualified taxpayer per taxable year.

³ Under R&TC sections 25135 and 25136.

⁴ R&TC section 25137.

⁵ Under Internal Revenue Code section 408.

⁶ Established pursuant to Government Code section 100012.

If this is different than the author's intent, the author may want to amend the bill to clarify that the maximum amount of the credit would be limited to \$1,000 per employee per taxable year.

This bill uses a phrase that is undefined, i.e., "gross receipts, less returns and allowances, derived from or attributable to this state." The absence of a definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define the phrase.

The bill uses a phrase i.e., "gross receipts, less returns and allowances reportable to this state" and provides a definition that doesn't limit the gross receipts to this state. The conflict of the phrase and definition could lead to confusion with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clarify the phrase to "gross receipts, less returns and allowances".

When determining the "gross receipts, less returns and allowances reportable to this state," the reference phrase should be changed to "gross receipts, less returns and allowances, derived from or attributable to, this state" for consistency and clarification; otherwise, the conflicting phrases would complicate the administration of this bill. The author may want to amend the bill to change the phrase for consistency.

The language that would authorize the FTB to prescribe rules, guidelines, procedures, or regulations to carry out the purposes of this bill contains unnecessary language. The bill should be amended to remove "rules, guidelines, procedures, or" from page 5, lines 10 through 11 and page 8, lines 35 through 36.

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.

It is unclear how the FTB would have access to the information to prepare a written report to the Legislature that contains the percentage of employees who are receiving matching contributions who under 30 years of age, as well as the percentage of employees earning less than \$40,000 per taxable year. Without the information, the FTB would be unable to prepare the written report to the Legislature. The author may want to amend the bill to revise the information contained in the written report to the Legislature.

Under this bill, an insured bank or financial institution, maintaining a participating employee's Employee Savings Match Plan account, would be required to provide information to the qualified taxpayer and each participating employee to prepare a Form 1099 for each employee, at the time and in the manner as the FTB may prescribe. In general, federal law requires a bank or financial institution to provide a Form 1099 to each account holder for interest and dividends earned on accounts. This language would be problematic and unprecedented to have the FTB prescribe that a federal Form 1099 would be prepared based on the amounts of contributions and withdrawals of the participating employee. The author should amend this bill to remove the requirement to prepare a Form 1099 for each employee.

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

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 1272 As Amended May 4, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
-\$2.7	-\$2.5	-\$2.7

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 60 percent, or approximately 420,000 ($\approx 700,000 * 60$ 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 business have annual gross receipts of less than \$10 million. Therefore, it is assumed that approximately 375,000 ($\approx 420,000 * 90$ 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 56,000 ($\approx 375,000 * 15$ 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 ($\approx 56,000 * 15$ percent), of these small businesses would be solvent and match employee contributions 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 ($\approx 8,500 * 6$) employees eligible to participate. Based on data available, it is estimated that 20 percent of employees, or 10,000 ($\approx 51,000 * 20$ percent), would participate in the Employee Savings Match Plan. However, in the first year this amount is reduced by 25 percent to account for the timing of enactment and employers having enough time to make timely contributions to match employee's contribution to their Employee Saving Match Plan accounts.

It is assumed that employees would contribute on average \$800 to the plan per year and employers would match these contributions. After multiplying the assumed contribution amount by the estimated number of employees, the total estimated contributions would be

\$6 million ($\approx 10,000$ employees * 75 percent * \$800) in 2016. The estimated amount of contributions is reduced by 15 percent, or approximately \$5.2 million ($\approx \6 million * 85 percent) to account for employees who would withdraw from their Employee Savings Match Plan account within 12 months from their first contributions. Therefore, the total contributions are estimated to be \$5.2 million in 2016.

Employers would not be allowed a credit for matching contributions made to employees who withdrew contributions within 12 months of their first contribution or 12 months after their last withdrawal or the next taxable year. Therefore, for future years, the estimate assumes the amount of employer's matching contributions would be reduced due to the credit restriction.

The credit generated would be 50 percent of qualified contributions, resulting in an estimated \$2.6 million ($\approx \5.2 million * 50 percent) in credit generated in 2016. The amount of credit that each qualified taxpayer could use would be limited by the qualified taxpayer's current year tax liability. The estimate assumes 75 percent, or \$1.9 million ($\approx \2.6 million * 75 percent), 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, a qualified taxpayer may not claim a deduction for the matching contributions used in computing the credit. The estimated contributions of \$5.2 million is multiplied by an average tax rate of 6 percent resulting in an estimated revenue gain of \$300,000 ($\approx \5.2 million * 6 percent). This gain is added to the revenue loss from the credit for a total estimated revenue loss of \$1.6 million ($\1.9 million - \$300,000) 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.

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