

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Speier Analyst: Gloria McConnell Bill Number: SB 785

Related Bills: _____ Telephone: 845-4336 Introduced Date: 02/25/99

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Household Workers Tax Reporting/Employer Report on PIT Return/Conformity

SUMMARY OF BILL

Under this bill, as it directly affects the Franchise Tax Board (FTB), employers that employ individuals to perform domestic services and are required to pay state disability insurance or unemployment insurance and training tax and to withhold personal income tax would be required, concurrent with the filing of their personal income tax return, to file with the Franchise Tax Board (FTB), instead of the Employment Development Department (EDD), their annual report of wages and withholding and to submit payment thereof.

In addition, the bill would eliminate the quarterly wage reporting to EDD for the above employers. This provision does not directly affect FTB, but is currently a federal requirement for states. Further, the bill requires EDD, in the case of a claim for unemployment benefits filed during the taxable year, to estimate the amount of claim based on the claimant's written evidence or, in the absence of any evidence, an assumed \$5,000 in wages. Upon receipt of the employer's information filed annually with FTB, EDD would adjust the benefit and notify the claimant. This bill would be inoperative if the federal Department of Labor determines that the implementation of the act would result in nonconformity with federal law, but would thereafter become operative if the federal Department of Labor determines that amendments to federal or state law have placed this act in conformity with federal law.

EFFECTIVE DATE

This bill would be effective on or after January 1, 2000. According to the author's office, this is intended to apply for wages paid on or after January 1, 2000.

PROGRAM HISTORY/BACKGROUND

The FTB's primary responsibility is to administer the Personal Income Tax Law and the Bank and Corporation Tax Law. FTB's income tax return and processing system have been developed to expedite the banking of all payments, balancing of accounting records, issuing refunds, identifying math errors on the return and issuing notices to the taxpayer of balances that may be due. Typically, personal income taxes are paid through withholding, estimated taxes and/or tax credits. If, after application of the prepayments and tax credits, a tax balance exists, the amount is due and payable on April 15 following the close of the calendar year. However, generally, the taxpayer may be allowed up to a six month extension to file their income tax return.

Board Position:

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Department Director

Date

Gerald Goldberg

05/10/1999

Therefore, amounts paid on April 15 without an income tax return must be accompanied by a payment voucher.

Penalties and interest are computed based on the income tax return's balance due and due date of the return and the amount of payment. FTB's personal income tax system, like the Internal Revenue Service (IRS), uses the taxpayer's social security number (SSN) as the basis for the personal income tax account number. Under state law, as a part of the income tax return and its processing, taxpayers can voluntarily contribute to one of 11 charitable organizations. Under this process, if there is an overpayment of income tax, the excess (refund) may be applied as a voluntary contribution to a fund selected by the taxpayer. If there are insufficient funds to pay both the taxes and the selected fund, taxes are paid first.

Within the past five years, FTB began collecting nontax delinquencies: delinquent child support, court-ordered debts, student loans, and motor vehicle license fees. These collection programs are not part of income tax return processing. These collection programs are by law administered separate and apart from the administration of FTB's tax programs. If a debtor owes both taxes and nontax debts and collections are insufficient to satisfy both debts, the amount collected is applied first to taxes.

Personal income taxes are deposited into the Personal Income Tax Fund, and corporate taxes are deposited into the Bank and Corporation Tax Fund. For the delinquent child support and court-ordered debt collection programs, FTB informs the Controller of the amount collected, and the Controller transmits the amount collected to the referring county or court for distribution. For the delinquent student loan and motor vehicle license fee collection programs, FTB deposits the amounts it collects and transmits the amount deposited to the Student Aid Commission and Department of Motor Vehicles, respectively, for distribution.

More than 14 million personal income tax returns are filed and processed by FTB each year. A California resident can file one of three forms depending upon the complexities of the taxpayer's situation. A form 540EZ can be filed if:

- single or married filing joint, under 65 and not blind;
- no dependents;
- taxable income is \$50,000 or less and comes from wages, taxable interest of \$400 or less, salaries, tips, unemployment compensation, taxable scholarships or fellowship grants;
- no adjustments are made to the taxpayer's income (such as IRA deductions, moving expenses, etc.);
- the standard deduction is taken instead of itemized deductions;
- the only tax payment is withholding shown on the taxpayer's forms W-2;
- the only tax credit is a personal exemption credit; and
- the tax is figured using the tax table.

Most 540EZ filers can telefile and pay by mail.

A form 540A can be filed if:

- single, married filing joint, married filing separate, or head of household;
- the taxpayer's federal adjusted gross income is \$100,000 or less and comes from wages, salaries, tips, taxable scholarship or fellowship grants, interest and dividends, unemployment compensation, social security benefits, Tier I and Tier II railroad retirement payments and/or fully and partially taxable IRA distributions, pensions and annuities;

- California and federal adjustments to income (such as IRA deductions, moving expenses, etc.) are the same;
- standard deductions or California itemized deductions are the same as federal except for state, local and foreign taxes paid;
- the tax payments are from withholding shown on forms W-2, W-2G, 1099-R, estimate payments, payments made with extension voucher, form FTB3519 and/or excess State Disability Insurance (SDI) or Voluntary Plan Disability Insurance (VPDI);
- the only tax credits are personal exemption, senior exemption and/or blind exemption credits; and
- the taxpayer figures his or her tax using the tax table or the tax rate schedules.

If a resident taxpayer does not qualify to use either form 540EZ or form 540A, the taxpayer must use form 540. The California income tax booklet for the 540 tax return and instructions contains 56 pages.

Nonresidents, which includes part-year residents, must file a 540NR. The tax rate is determined based on federal income as adjusted for California purposes. Then the tentative computed tax is apportioned based on the ratio of California adjusted gross income to total adjusted gross income.

Information contained on an income tax return received April 15 of a given year may not be available for dissemination until late June. Information received on an income tax return received on or before October 15 (an extension of time to file) may not be available for dissemination until December.

The EDD administers the laws for the following "employer taxes:"

- Unemployment Insurance Tax (UIT),
- State Disability Insurance Tax (SDI),
- Employment Training Tax (ETT), and
- Withholding of Personal Income Tax (PIT).

Depending upon the particular tax, the amount remitted to EDD by the employer may be an amount withheld from the employee's wages or an amount paid by the employer on the employee's wages. Generally, employers report wages on a quarterly basis, which includes the amount of wages subject to withholding, file an annual wage reconciliation statement and remit the taxes periodically in accordance with the various laws. Employer taxes are deposited into various funds: the Unemployment Fund, the Employment Development Department Contingent Fund, the Employment Training Fund, the Disability Fund, and the Personal Income Tax Fund. Additionally, EDD administers the unemployment compensation benefit program, as well as other service programs.

According to EDD staff, the term "domestic services" under the Unemployment Insurance Code (UIC) and related federal laws is the same as "household employment." According to EDD's Information Sheet available on the Internet, "household employment is provided in a variety of settings, such as in your private home, a local college club or the local chapter of a college fraternity or sorority. Household workers (employees) may include, but are not limited to, cooks, waiters, waitresses, butlers, housekeepers, governesses, governesses, maids, valets, babysitters, home health care workers, janitors, laundresses, furnace persons, gardeners, chauffeurs, crews of private yachts and pilots of private airplanes for family uses.

Household employment does not include services performed by private secretaries, tutors, librarians, musicians, carpenters, plumbers, electricians, painters or other skilled craftsmen."

The following chart reflects when a household employer is subject to employer taxes. If an employer pays wages for household employment of \$750 or more in a calendar quarter, the employer must report the wages subject to SDI and withhold and remit the amount due from the employee's wages. The withholding and remittance is required through the remainder of the year and the following year, even if less than \$750 is paid in subsequent quarters. When paying cash wages of \$1,000 or more for household employment in a calendar quarter, the person must report wages and pay UIT and ETT on the wages, in addition to SDI. As with SDI, the withholding and remittance for UIT and ETT is required through the remainder of the year and the following year, even if less than \$1,000 is paid in subsequent quarters. These tax rates and wage limits are subject to change annually. Generally, once cash wage limits are met, all cash and non-cash amounts are includible as subject wages. EDD uses the quarterly wage reporting to administer the unemployment compensation benefit program, which is paid by federal funds and therefore governed by many federal requirements. State law does not require household employers to withhold PIT from the wages of household employees. However, upon agreement with the employee, the household employer may withhold and remit PIT to EDD.

If the household employer pays cash wages in a calendar quarter of:	For the following taxes, the household employer:			
	SDI	UI	ETT	PIT withholding
\$750 or more but less than \$1,000	Required to withhold and remit from wages	Not applicable	Not applicable	Upon agreement with employee, may withhold and remit from wages
\$1,000 or more	Required to withhold and remit from wages	Required to pay unemployment taxes	Required to pay employment training taxes	Upon agreement with employee, may withhold and remit from wages

Special filing and remittance rules are provided for certain household employers. Employers of household workers who pay total wages of \$20,000 or less per year can elect to remit their employer taxes to EDD annually. The household employer is still required to report quarterly the wages and the wage amounts subject to the particular tax and file the annual wage reconciliation statement, but is allowed to remit the employer taxes only once a year, in January following the close of the calendar year.

In addition, any employer with five or fewer employees may telefile and remit the employer taxes annually electronically with EDD. According to EDD staff, employers of household workers typically have four or fewer employees.

According to EDD staff, there are approximately 31,000 employers of household workers. Of these 31,000 employers, approximately 11,000 remit annually. Of the 31,000 employers, only 800 telefile. EDD's Tax Guide for California Employers of Household Workers contains 67 pages.

Currently, if quarterly wage information is not available when a claim for unemployment is received by EDD, the claim must be manually processed by contacting the employer. Manual processing these claims takes considerable time and is more costly than where quarterly wage information is available.

Federal law requires employers of household workers to withhold and remit Social Security and Medicare Taxes (FICA), report wages and remit Federal Unemployment Tax (FUTA) and, upon voluntary agreement with the employee, to withhold and remit individual income taxes. However, employers are permitted to report and remit FICA, FUTA and, in some cases, any income tax withholding on an annual basis with the filing of the employer's federal individual income. As previously indicated, federal law requires quarterly wage reporting by states for the purposes of administering the state's unemployment compensation laws, which operate under federal DOL oversight because of the sharing of FUTA.

At the FTB Taxpayer Bill of Rights Hearing on November 17, 1997, Spidell Publishing raised the issue of whether California could simplify the reporting and payment of taxes for employers of household workers by allowing these employers to report and pay these taxes annually on their state income tax return. In an effort to ease the filing requirement, FTB voted to lobby for federal legislation to eliminate the federal unemployment insurance quarterly wage reporting requirement for household employers. This year two federal Senate bills (S. 331 and S. 369) were introduced that would allow states to permit employers that file annually using the federal income tax return to make wage reporting on an annual basis. The federal law would apply to wage reports required to be submitted on or after the date of enactment of the federal act.

SPECIFIC FINDINGS

Currently, a household employer reports quarterly wage information to and files its annual reconciliation statement with EDD. The remittance of the employer tax is periodic, unless wages paid are \$20,000 or less, in which case the remittance occurs annually.

Under this bill, employers of household workers required to withhold PIT would be required to file their annual withholding report, report of wages and pay SDI, UIT, ETT, and any PIT withholding, concurrent with the filing of their PIT return, with the FTB, instead of the EDD.

In addition, the bill would eliminate EDD's quarterly wage reporting for the above employers. Further, the bill requires EDD, in the case of a claim for unemployment benefits, to estimate the amount of claim based on the claimant's written evidence or, in the absence of evidence, an assumed \$5,000 in wages. Upon receipt of the employer's annual wage information filed with FTB, EDD would adjust the benefit and notify the claimant. This bill would be inoperative if the federal Department of Labor determines that the implementation of the act would result in nonconformity with the requirements of federal law.

The bill would remain inoperative unless the federal Department of Labor determines that amendments to federal or state law would place this act in conformity with the requirements of federal law.

Policy Considerations

- "One stop shopping" through the income tax return system may lessen the employer tax gap. The bill may result in more employers reporting wages and paying the taxes for their household workers.
- To modify California's income tax return to accommodate 31,000 employers could disrupt the processing of 14 million tax returns. The inclusion of this employer item may cause confusion for taxpayers who do not have employees or employers of other than household workers.
- An April 20, 1998, Tax Notes article, attributed to an April 5, 1998, New York Times article, indicates that "four years after Congress simplified the requirements for reporting wages paid to nannies and other household workers and for paying the employer's share of the payroll taxes, most employers are not obeying the law. The number of people paying the tax fell from nearly 500,000 in 1994 to 314,000 in 1996. The IRS estimates that as many as 4 million people should be paying the tax each year."
- The IRS can more easily accommodate the processing of employer taxes in conjunction with individual income taxes because it administers and collect all affected taxes. In addition, the federal government does not need the wage information during the year to administer an unemployment compensation benefit program.

Implementation Considerations

If the employer tax reflected on the PIT return is unpaid, it is understood by FTB, EDD and the author's staff that FTB would not compute penalties or interest on the employer tax, or bill the individual for any underpayments of the employer tax. FTB would exchange the information with EDD, and EDD would bill the employer, collect any delinquencies and conduct any audits as authorized under the UIC.

Staff, however, raises the following implementation issues as discussed with the author's staff and, upon request, will work with the author's staff to resolve them.

Definition of "nonconformity" -- It is unclear what is meant by "nonconformity." If Congress enacts language to eliminate quarterly filing (S. 331 or S. 369), it is unclear whether this alone would be considered conformity with the requirements of federal law for purposes of this bill. If the federal DOL takes issue with the bill's requirement that a claimant's wages be automatically set at \$5,000 preliminary to receiving the annual wage information, it is unclear whether this also would be considered "nonconformity" and render the bill inoperative.

Conditional operative date -- It is unclear as to how FTB and the taxpayer would know whether the federal DOL has determined that the implementation of this act would result in nonconformity with the requirements of federal law, thereby rendering the bill inoperative.

Without a date certain as to when the federal determination must be made for the employer tax to be included on the PIT return for a given year and a state agency designated as responsible for making the federal determination public, the operative date of this bill is very uncertain and could cause confusion.

It is also uncertain whether the vagueness of this futuristic conditional operative date could be construed to be an unconstitutional delegation of the state's power to the federal government to make laws for the state.

Proposed federal law -- The proposed federal law would eliminate the requirement for filing of state quarterly wage information only if the employer files his or her household worker's employment tax through the IRS tax return. It is unclear, therefore, whether this bill should be limited to only those employers who file their federal employer taxes through the federal individual income tax.

Funding/Budget -- FTB's departmental costs for PIT processing is a General Fund expenditure. FTB's costs for implementing and processing this employer tax would be paid from federal funds. To separately track these expenditures from PIT expenditures would increase FTB's departmental costs. In addition, the separate funding source would create a more complex budget process for FTB.

Technical Considerations

According to discussion with the author's office, the bill will be amended to accomplish the following. Staff will work with the author to draft the necessary amendments:

Eligible taxpayers -- This bill is intended to apply to all employers of household workers without regard to whether they are required to withhold PIT.

Effective Date -- This bill is intended to apply to wages due and payable on or after January 1, 2000, which would be reflected on the PIT calendar year 2000 return, processed in 2001.

Priority of overpayment in excess of PIT -- If the taxpayer's PIT withholding, estimated tax payments and other PIT credits exceed the taxpayer's PIT liability, the excess over the PIT liability would be applied to the employer taxes, and lastly to any voluntary contribution funds.

Priority if insufficient payments -- In the event withholding, estimated tax payments and/or other credits are insufficient to satisfy both the PIT and employer taxes, and the taxpayer makes payment with the PIT return that is insufficient to pay both the PIT and employer taxes, the employer taxes would be paid first to satisfy federal requirements. However, giving employer taxes priority over PIT on a PIT return may be a policy issue.

Original Return -- The employer would file the household employer tax on only an original PIT return. Amended returns for employer taxes would continue to be directly filed with and amounts due paid to EDD.

Transfer of Collections -- FTB would not transfer the money to the appropriate funds. To prevent the building of an accounting system separate and apart from its present PIT system, FTB would transfer these employer taxes to EDD for distribution into the appropriate funds.

FISCAL IMPACT

Departmental Costs

Based on the assumptions that necessary federal legislation will be enacted and that the technical amendments previously discussed will be made as discussed with the author's office, staff anticipates that having the employer tax on the PIT return would require at least minimal integration into the PIT return's automated and manual validation process. Using the following assumptions, a preliminary implementation plan indicates start-up costs for fiscal year 1999-00 of approximately \$600,000 (\$445,000 one-time costs, including overtime for programming and testing, and \$155,000 ongoing costs). For fiscal year 2000-01 and thereafter, the costs would be approximately \$160,000. According to EDD, the costs for FTB to administer this bill would be paid from federal funds through a memorandum of understanding with EDD.

1. The household employer tax would be reported, filed and paid in conjunction with the 540 or 540NR PIT return only and would primarily affect: receiving, cashiering, fiscal accounting, return validation and the PIT automated accounts receivable. This analysis assumes no additional PIT returns would be filed as a result of this bill.
2. Approximately 27 items of information (several schedules) must be included with the PIT return to accommodate EDD's program needs. The ability to capture the data on an FTB computer system would require programming, testing and ongoing manual activities. FTB anticipates the development of technologies may allow for more efficient exchange of these data with EDD in the future.
3. Because of the existing length of each EDD booklet/guide and the importance for the taxpayer to receive all related information, both booklets would be sent to the 31,000 currently registered household employers. The 540 and 540NR tax returns would be redesigned to include a line item to reflect the employer tax, and the FTB booklet would instruct a household employer to refer to the EDD booklet to complete the total balance due. It is also assumed for purpose of this preliminary costing that relatively few taxpayers with household employees currently use the shorter 540A PIT return and would have to switch to the longer 540 PIT return to file this employer tax. It is also assumed that these taxpayers would not be allowed to file through FTB's telefile process/system.
4. FTB would use its existing marketing and educational resources to reach those PIT taxpayers who may not be currently registered with EDD as household employers.

5. As indicated under Implementation Considerations, FTB would not compute penalties or interest on the employer tax, or bill the individual for any underpayments of the employer tax. FTB would exchange the information with EDD, and EDD would bill the employer, collect any delinquencies and conduct any audits as authorized under the UIC.

Tax Revenue Estimate

It is not anticipated that this bill would affect the tax laws administered by FTB. This analysis does not assume additional PIT returns would be filed as a result of this bill.

BOARD POSITION

Pending.