Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Brough	Analyst:	Jessica Deitchman	Bill Number:	AB 1071
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	March 29, 2017
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Employer Wages Paid to Qualified Full-Time Aerospace Employees Credit

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), create a tax credit for qualified taxpayers that increase workforce.

RECOMMENDATION – NO POSITION

Summary of Amendments

The March 29, 2017, amendments removed provisions of the bill relating to the definition of taxpayer in the CTL, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill and only addresses the provisions that impact the department.

REASON FOR THE BILL

The reason for the bill is to encourage job expansion in the aerospace industry by offering employers in this state a tax credit for those employers that increase and maintain employment levels.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for each taxable year beginning on or after January 1, 2018.

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.

For taxable years beginning on or after January 1, 2014 and before January 1, 2025, current state law allows a California Competes Tax Credit (CA Competes Credit),administered by the Governor's Office of Business and Economic Development (GO-Biz). The CA Competes Credit was enacted to create more jobs in California. The amount of the credit available to a taxpayer for a taxable year is negotiated and set forth in a written agreement between GO-Biz and a taxpayer, and approved by the "California Competes Tax Credit Committee," consisting of the State Treasurer, the Director of the Department of Finance, the Director of GO-Biz, and one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

THIS BILL

For each taxable year beginning on or after January 1, 2018, this bill would, under the PITL and CTL, allow a tax credit to a qualified taxpayer in an amount equal to 17.5 percent of qualified wages paid or incurred during the taxable year with respect to a qualified employee, not to exceed $25 million per qualified taxpayer per taxable year.

The bill would define the following:

- "Qualified employee" means a full-time employee.
- "Qualified taxpayer" means a person that is engaged in a trade or business that meets both of the following requirements:
    - Is either:
        - Not engaged in a trade or business in this state before January 1, 2018, or
        - Is engaged in a trade or business in this state before January 1, 2018 and has a net increase in full-time qualified employees on or after January 1, 2018.
    - Is an aerospace entity.

  Qualified taxpayer would specifically exclude a person that is located within a 25-mile radius of any other person in engaged in a businesses or trade of like kind.
- "Qualified wages" means wages subject to withholding under Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.

The credit would only be allowed to a qualified taxpayer for five consecutive taxable years, beginning on the date the taxpayer either first engages in trade or business in this state or first has a net increase in full-time employees.

The credit may be carried over for up to six years, until exhausted.

Any deduction otherwise allowed for any amount included in the calculation of this credit would be required to be reduced by the amount of the credit allowed.

The FTB would be allowed to prescribe rules, guidelines, or procedures necessary or appropriate to implement the credit. Any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB would be excluded from the provisions of the Administrative Procedures Act.

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 uses terms that are undefined, i.e., "aerospace entity," "like kind," "full-time qualified employee," and "full-time employee." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

The definition of qualified taxpayer in this bill would specifically exclude "a person that is located within a 25-mile radius of any other person in engaged in a business or trade of like kind." It is unclear how taxpayers and the department would determine whether the exclusion applies. To avoid disputes between taxpayers and the department, this bill should be amended.

It is unclear how, when, and how often the determination of a net increase in full-time qualified employees would be done. Additionally, the bill is silent on the length of time that the specified net increase would be required to be maintained. As a result, once the credit is triggered a qualified taxpayer would be eligible for the credit for five taxable years regardless of whether and for how long the increase is maintained. For clarity and to insure consistency with the author's intent, this bill should be amended.

The initial taxable year of the five taxable years that the credit would be available is unclear. For example, would the initial year the credit could be claimed be the taxable year during which the increase in full-time qualified employees occurred? If an increase occurred halfway through a taxable year, would the credit for that year be prorated? To avoid disputes between taxpayers and the department and to insure consistency with the author's intent, this bill should be amended. The author may wish to amend the bill to clearly define how many complete taxable years the credit would be allowed.

LEGISLATIVE HISTORY

AB 927 (Muratsuchi, 2013/2014) would have created a tax credit for an aerospace employer that hires certain new employees. AB 927 failed to pass out of the house of origin by the constitutional deadline.

SB 414 (Knight, 2013/2014) would have created two income tax credits for qualified employers in the aerospace sector. The first tax credit for costs paid to reimburse qualified employees for tuition costs and the second for wages paid to certain qualified employees that receive an undergraduate or graduate degree in the state. SB 414 failed to pass out of the Assembly by the constitutional deadline.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable tax credit. 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 AB 1071 As Amended on March 29, 2017 Assumed Enactment After June 30, 2017 ($ in Millions)		
2017-18	2018-19	2019-20
- $21	- $60	- $100

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 Los Angeles Economic Development Corporation Institute for Applied Economics and the FTB, it is estimated that $450 million in California aerospace wages would be paid to qualified employees in 2018. Applying a 17.5 percent credit against qualified wages would result in a credit generated of $79 million. It is estimated that 60 percent or $47 million of credit will be used in the year generated with the remainder used over the next five years. Under the bill's provision, the wage expense deduction is reduced by the amount of credit generated. Applying the marginal corporation tax rate of 5 percent to the estimated credit generated would result in an offset in the form of an increase to revenue of $4 million in 2018. The overall net impact would be a revenue loss of $42 million in taxable year 2018 and increasing to $170 million in taxable year 2022.

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 businesses to increase employment in this state by offering a tax credits for those that increase their workforce.

Opponents: Some may argue that this bill is unnecessary as there are existing wage-based credits available to the employers that this bill would target.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill would allow taxpayers to claim multiple tax benefits for the same item of expense because wages paid to employees may be eligible under another provision of state tax law for a wage credit.

LEGISLATIVE STAFF CONTACT

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