

**ANALYSIS OF AMENDED BILL**

Author: <u>Choi, et al.</u>	Analyst: <u>Jessica Deitchman</u>	Bill Number: <u>AB 1216</u>
		Introduced Date <u>February 17, 2017</u>
		Amended Date <u>April 5, 2017</u>
Related Bills: <u>See Legislative History</u>	Telephone: <u>845-6310</u>	Revised Date: <u>April 6, 2017</u>
	Attorney: <u>Bruce Langston</u>	Sponsor: _____

**SUBJECT:** Employer Hiring Credit/Increase Employment by 20 Full Time Equivalentents

**SUMMARY**

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

**RECOMMENDATION – NO POSITION**

**Summary of Amendments**

The April 5, 2017, amendments added co-authors<sup>1</sup> and modified provisions of the tax credit as introduced on February 17, 2017. This is the department’s first analysis of the bill.

**REASON FOR THE BILL**

The reason for the bill is to encourage employers in this state to expand their workforce by offering a tax credit.

**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, and before January 1, 2025.

**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.

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<sup>1</sup> April 6, 2017, revised version showed the addition of co-authors.

Introduced February 17, Amended April 5, and revised April 6, 2017

Current state law allows a New Employment Credit that (NEC) 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.

## **THIS BILL**

For each taxable year beginning on or after January 1, 2018, and before January 1, 2025, 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 to a qualified employee, not to exceed \$25 million per qualified taxpayer per taxable year.

The bill would define the following terms and phrases:

- “Annual full-time equivalent” means either of the following:
  - In the case of a qualified employee paid hourly qualified wages, “annual full-time equivalent” means the total number of hours worked for the qualified taxpayer by the qualified employee, not to exceed 2,000 hours per employee, divided by 2,000.
  - In the case of a salaried qualified employee, “annual full-time equivalent” means the total number of weeks worked for the qualified taxpayer by the qualified employee divided by 52.
- “Base year” means either:
  - 2018 taxable year in the case of a qualified taxpayer engaged in business in this state before January 1, 2018, or
  - In the case of a qualified taxpayer that first engages in business in this state on or after January 1, 2018, the first taxable year in which they engage in business in this state.
- “Qualified employee” means an employee who was not previously employed by the qualified taxpayer.
- “Qualified taxpayer” means a taxpayer that increases the workforce of the trade or business engaged in by the taxpayer by 20 annual, full-time equivalent qualified employees during the taxable year as compared to the number of employees employed by the taxpayer in the taxpayer’s base year, as tallied at the end of the taxpayer’s taxable year. Qualified taxpayer would specifically exclude a sexually oriented business.<sup>2</sup>
- “Qualified wages” means wages subject to withholding under Division 6 (commencing with Section 13000) of that Unemployment Insurance Code.

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<sup>2</sup> As described in Revenue and Taxation Code section 17053.73(b)(11)(C)(v).

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This credit would be allowed to a qualified taxpayer for five consecutive taxable years, beginning with the first taxable year that the qualified taxpayer increases the workforce of the trade or business engaged in by the taxpayer by 20 annual, full-time equivalent qualified employees as compared to the number of employees employed by the taxpayer in the taxpayer's base year, as tallied at the end of the taxpayer's taxable year.

The credit would be disallowed in any taxable year occurring within the five consecutive taxable years in which the employee increase, as compared to the number of employees employed by the taxpayer in the taxpayer's base year, is not maintained.

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

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

A deduction or credit otherwise allowed for any amount paid or incurred by the qualified taxpayer upon which the credit is based would be allowed in full.

The FTB may adopt regulations as necessary or appropriate to carry out the purposes of this section, including any regulations necessary to clarify whether a taxpayer meets the requirements for being properly treated as a qualified taxpayer.

The bill would provide an exemption from the Administrative Procedures Act<sup>3</sup> for any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB.

This section would remain in effect until December 1, 2025, and would be repealed as of that date.

## **IMPLEMENTATION CONSIDERATIONS**

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

The bill would allow employers to move employees to another entity within the combined group and have them counted as an increase in employment. For example, if there are corporations A, B, and C in a combined group, corporation A could hire an employee into corporation A and then move the employee to corporation B and have that count as an "increase in employment," as defined in the bill. If this is contrary to the author's intent, the bill should be amended.

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<sup>3</sup> Government Code Title 2 Division 3 Part 1 Chapter 3.5 (commencing with Section 11340).

## **TECHNICAL CONSIDERATIONS**

The bill uses the phrase, "employed by the taxpayer in the taxpayer's base year, as tallied at the end of the taxpayer's taxable year" which is unclear. It is suggested that this phrase be replaced with "employed by the taxpayer as of the last day of the taxpayer's base year," which may provide more clarity.

For consistency, all references to "taxpayer" should be amended to read "qualified taxpayer."

## **LEGISLATIVE HISTORY**

AB 661 (Fuller, 2017/2018) would expand the NEC by modifying eligibility for the credit, the definition of qualified employee and the credit's calculation. SB 661 was introduced on February 17, 2017.

SB 507 (Hueso, 2017/2018) would expand the NEC by adding two new types of qualified employees. SB 507 was introduced on February 16, 2017.

SB 1216 (Hueso, 2015/2016) would have allowed a credit to a qualified employer who employed a qualified employee who was an ex-felon. SB 1216 failed to pass out of the house of origin by the constitutional deadline.

AB 1404 (Grove, 2015/2016) would have allowed a credit to a qualified employer who employs a qualified employee and pays the qualified employee a wage that exceeds the minimum wage during the taxable year. AB 1404 failed to pass out of the house of origin by the constitutional deadline.

SB 90 (Galgiani and Canella, Chapter 70, Statutes of 2013) modified AB 93 as chaptered on July 11, 2013. Specifically, SB 90, for purposes of the NEC, modified the definition of qualified employee, excluded sexually oriented businesses from the definition of qualified taxpayer and small business, and modified the defined geographical area that the hiring credit may be generated in.

AB 93 (Assembly Committee on Budget, Chapter 69, Statutes of 2013) repealed the geographically targeted economic development area tax incentives and the New Jobs Tax Credit under the PITL and CTL, created a NEC, established the California Competes Tax Credit Committee, and created the California Competes Credit under the PITL and CTL.

## **OTHER STATES' INFORMATION**

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax credits. 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 1216 As Amended April 5, 2017 Assumed Enactment After June 30, 2017 (\$ in Billions)		
2017-18	2018-19	2019-20
\$0	- \$4.1	- \$3.0

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 Employment Development Department and the FTB, it is estimated that \$400 billion of qualified wages would be paid to California employees in 2018. Applying the credit of 17.5 percent results in an estimated credit generated of \$70 billion in 2018. Using the estimated average tax liability for small, medium, and large businesses, it is estimated the credit used would be \$2.8 billion in 2018 and any remaining credit would carryover to future years.

The tax year estimate is converted to fiscal years, rounded and is 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.

Opponents: Some may argue that the bill’s provisions are overly complex and could result in underutilization of the credit.

## **POLICY CONCERNS**

This bill would specifically allow taxpayers to claim multiple tax benefits for the same item of expense.

## **LEGISLATIVE STAFF CONTACT**

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