

ANALYSIS OF AMENDED BILL

Author: Choi, et al. Analyst: Jessica Deitchman Bill Number: AB 1216
Related Bills: See Legislative History Telephone: 845-6310 Amended Date: May 16, 2017
Attorney: Bruce Langston Sponsor: _____

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

SUMMARY

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

RECOMMENDATION – NO POSITION

Summary of Amendments

The May 16, 2017, amendments added co-authors, limited the availability of the credit to CTL taxpayers, modified the definition of qualified taxpayer, changed the per taxpayer cap, and added provisions requiring the Franchise Tax Board (FTB) to administer and cap the credit.

This analysis replaces the department's analysis of the bill as amended April 5, 2017.

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, contingent on a budget measure specifically appropriating funds to the FTB for costs to administer the bill's provisions.

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 (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 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, contingent on a budget measure specifically appropriating funds to the FTB for costs to administer the bill's provisions, allow a tax credit under the CTL 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 \$5 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 meets both of the following requirements:
 - Employs over 50 employees during the taxpayer's base year.
 - 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.¹

“Qualified wages” means wages subject to withholding under Division 6 (commencing with Section 13000) of that Unemployment Insurance Code.

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 aggregate amount of credits that may be allocated shall be an amount equal to the sum of both of the following:

- Fifty million dollars (\$50,000,000) in credits for each calendar year.
- The unused allocation credit amount, if any, for the preceding calendar year.

The FTB shall do both of the following:

- On or after January 1, 2018, and before January 1, 2025, allocate and certify tax credits to taxpayers on a first-come-first-served basis by determining and designating applicants who meet the requirements of this section.
- Once the credits allocated exceed the limits established, the FTB shall cease to allocate and certify tax credits to taxpayers.

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 Act² for any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB.

¹ As described in Revenue and Taxation Code section 17053.73(b)(11)(C)(v).

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

This provision 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.

For a corporation just beginning business in this state, the base year is defined as the first taxable year. As a result, the credit would be unavailable to corporations' just starting business in this state in the first taxable year. If this is contrary to the author's intent, the bill should be amended. 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.

Because the bill lacks an allocation process and instead ends the credit when the cap is met, taxpayers would lack certainty of the credit's availability until after their return was filed and the credit was allocated by the FTB. Additionally, because the demand for the credit could exceed the cap amount, taxpayers that claim the credit and are subsequently denied the credit by the FTB because the cap has been reached could be subject to penalties and interest. If this is contrary to the author's intent, the bill should be amended.

The bill lacks administrative details necessary for the FTB to administer a cap on the credit. For example,

- How would the department allocate and certify credits among returns filed on the same day when the total amount of credit claimed would exceed the remaining amount available for allocation? Allow 100 percent of the credits on those returns? Prorate the remaining credit among those returns?

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 provides more clarity.

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

The bill's specified operative date language is silent as to the taxable years the bill would affect. For clarity and ease of administration, subdivision (j) should be amended to read, "Notwithstanding subdivision (a), this section shall not apply for taxable years where the annual budget act lacks a specific appropriation of funds to reimburse the FTB for its costs of administering this section with respect to that taxable year."

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 is currently in the Senate Governance and Finance Committee.

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 Personal Income Tax Law (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 May 16, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)			
	2017-18	2018-19	2019-20
Hiring Credit	\$0	- \$71.5	- \$50.5
Underpayment Penalty	\$0	+ \$1.5	+ \$1.5
Net Revenue	\$0	- \$70.0	- \$49.0
*Estimates assumes a specific appropriation of funds to the FTB would be enacted in 2018 and each year thereafter for its costs to administer the credit.			

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 \$10 billion of qualified wages would be paid to California employees in 2018 by qualified employers. Applying the credit of 17.5 percent results in an estimated credit generated of \$1.75 billion in 2018. It is estimated that 4 percent of qualified employers would have sufficient liability to claim the credit in the year generated. This results in taxpayers claiming approximately \$70 million in credits in the 2018 taxable year.

Under the bill's provisions, the aggregate amount of credit that can be allocated in each calendar year is limited to \$50 million plus the prior year's unused allocated amount. It is assumed that the credit would be oversubscribed each year resulting in claim denials of approximately \$20 million.

Taxpayers who claim the additional \$20 million in credits would be assessed approximately \$1.5 million in underpayment and monthly penalties. The net impact of the credit usage, the decrease in deductions, and the penalties issued due to the understatement of tax results in an estimated revenue loss of \$48 million in the 2018 taxable year.

The tax year estimate is converted to fiscal years and rounded to arrive at the amounts reflected in the above table.

SUPPORT/OPPOSITION³

Support: Greater Irvine Chamber of Commerce, Los Angeles Area Chamber of Commerce, National Federation of Independent Business, Orange Chamber of Commerce.

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.

This bill would provide a tax benefit for those taxpayers subject to the CTL that would not be provided to taxpayers subject to the PITL. Thus, this bill would provide differing treatment based solely on classification.

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³ As provided in the Assembly Revenue and Taxation Committee Analysis dated May 5, 2017.