



Analysis of Amended Bill

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Bill Number: AB 2932

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Related Bills: See Legislative
History

Amended: March 20, 2018

Subject: Employer Hiring Credit/Qualified New Employee Wages

Summary

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

Recommendation – No position.

Summary of Amendments

The March 20, 2018, amendments removed the intent language and replaced it with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for this bill is to improve the business climate for businesses considering locating to or expanding in the state.

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, 2019, and before January 1, 2026, contingent on a budget measure specifically appropriating funds to the Franchise Tax Board (FTB) 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 federal and state 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 (NEC) 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. A qualified taxpayer must receive a tentative credit reservation from the FTB for that qualified full-time employee.

Under Revenue and Taxation Code section 41, legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the credit's effectiveness.

This Bill

For each taxable year beginning on or after January 1, 2019, and before January 1, 2026, 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:
 - The 2019 taxable year in the case of a qualified taxpayer engaged in business in this state before January 1, 2019, or
 - In the case of a qualified taxpayer that first engages in business in this state on or after January 1, 2019, 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 who meets the following conditions:
 - Employs over 20 employees during the taxpayer's base year, and
 - 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 as of the last day of the taxpayer's base 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 the 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.

This bill would also provide the following:

- Employees of trades or businesses that are treated as related under Internal Revenue Code (IRC) sections 267, 318, or 707 are treated as employed by a single qualified taxpayer.
- Employees of corporations that are members of the same controlled group of corporations are treated as employed by a single qualified taxpayer.
- The credits allowable and allocated to each member is determined by the proportional share of the expense of the qualified wages giving rise to the credit.
- If a qualified taxpayer acquires the major portion of a trade or business of another taxpayer (the predecessor), for purposes of application of this credit for any taxable year ending after the acquisition, the relationship between the annual full-time equivalent qualified employee and a qualified taxpayer will not be treated as terminated if the employee continues in the trade or business.

“Controlled group of corporations” means a controlled group of corporations as defined in IRC section 1563(a), except for certain insurance companies and stocks owned by employees’ trust. And, the total combined voting power of all classes of stock and total value of shares of all classes of stock are “more than 50 percent” instead of “at least 80 percent” as specified in IRC section 1563(a)(1).

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

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

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

The FTB would be required to do both of the following:

- On or after January 1, 2019, and before January 1, 2026, allocate and certify tax credits to qualified taxpayers on a first-come-first-served basis by determining and designating applicants who meet the requirements of this bill.
- Once the credits allocated exceed the limits established, cease allocating and certifying tax credits to qualified taxpayers.

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 credit must be claimed on a timely filed original return.

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.

Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code would not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB.

This provision would remain in effect until December 1, 2026, and would be repealed as of that date.

This bill includes off code language stating the specific goals, purposes, objectives, and performance measures, as required by R&TC section 41.

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.

Because a qualified taxpayer that is operating in the state would have taxable year 2019 as the base year, and taxable year 2019 is the first year the credit would be available, the credit would be unavailable until taxable year 2020. If this is contrary to the author's intent, the author may wish to amend this bill to specify taxable year 2018 as the base year for businesses operating within the state prior to January 1, 2019. 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.

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 qualified taxpayer in the taxpayer's base year, as tallied at the end of the taxpayer's taxable year" (page 3, line 26, 27) which is unclear. It is suggested that this phrase be replaced with "employed by the qualified taxpayer in the taxpayer's base year, tallied as of the last day of the taxpayer's taxable year" to provide more clarity.

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 (k) 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 1216 (Choi, 2017/2018), would have, 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. Qualified taxpayer would be defined as employing over 50 employees in the base year and increasing the workforce by 20 annual fulltime equivalents over the base year number during the taxable year. AB 1216 failed to pass out of the house of origin by the constitutional deadline.

SB 661 (Fuller, 2017/2018) would have expanded 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.

AB 1404 (Grove, 2015/2016) would have allowed a credit to a qualified employer who employs a qualified employee and pays a 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 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 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.

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.

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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2932 as Amended on March 20, 2018
For Taxable Years Beginning On or After January 1, 2019, and Before January 1, 2026
Assumed Enactment after June 30, 2018

Hiring Credit (\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$15.0
2019-2020	- \$50.0
2020-2021	- \$55.0

Underpayment Penalty (\$ in Millions)

Fiscal Year	Revenue
2018-2019	\$5.7
2019-2020	\$19.0
2020-2021	\$19.0

Net Revenue Impact (\$ in Millions)

Fiscal Year	Revenue*
2018-2019	- \$9.1
2019-2020	- \$31.0
2020-2021	- \$37.0

*Detail may not add to total due to rounding.

Estimates assume a specific appropriation of funds to the FTB would be enacted in 2019 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 or for the net final payment method of accrual.

Revenue Discussion

Based on data from the Employment Development Department (EDD) and the FTB, it is estimated that \$80 billion of qualified wages would be paid to California employees in 2019 by qualified employers. Applying the credit of 17.5 percent results in an estimated credit generated of \$14 billion in 2019. It is estimated that 2.4 percent of qualified employers would have sufficient liability to claim the credit in the year generated. This results in taxpayers claiming approximately \$340 million in credits in the 2019 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 taxpayers would report the maximum allocation of \$50 million in 2019, resulting in a revenue loss of \$50 million. However, because the bill lacks an allocation process, it is assumed that the credit would be oversubscribed each year resulting in claim denials of approximately \$290 million.

Taxpayers who claim the additional \$290 million in credits, above the credit cap of \$50 million, would be assessed approximately \$19 million in underpayment and monthly penalties. It is assumed the FTB would begin issuing penalty assessments in 2020 when the taxable year 2019 return is filed. The net impact of the credit usage and the penalties issued due to the understatement of tax results in an estimated revenue loss of \$31 million in the 2019 taxable year.

The tax-year estimate is converted to fiscal years, rounded and is reflected in the above table. Because the penalties relate to the prior year, they are accrued back one year.

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.

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 entity classification.

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