



Analysis of Amended Bill

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Sponsor:

Bill Number: AB 2957

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Amended: March 20, 2018

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Related Bills: See Legislative
History

Subject: Employer Wages Paid to Employees in Water Innovation & Technology Zone Credit

Summary

This bill would, under the Corporation Tax Law (CTL), allow a credit to a qualified taxpayer that employs a qualified employee in a water innovation and technology zone.

Recommendation – No position.

Summary of Amendments

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

This analysis only discusses the provisions that impact the department. This is the department's first analysis of the bill.

Reason for the Bill

The reason for the bill is to establish training for water professionals, and to incentivize new and emerging water efficiency, recycling, conservation treatment, and supply technologies, and to strengthen California's position as a global leader in water management by increasing the state's water research, development, and design.

Effective/Operative Date

This bill would be effective and operative January 1, 2019.

Federal/State Law

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.

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

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 for that qualified full-time employee.

This Bill

This bill would, under the CTL, for each taxable year beginning on or after January 1, 2019, allow a credit to a qualified taxpayer who employs a qualified employee in a water technology and innovation zone during the taxable year.

The credit would be equal to the sum of the following:

- Fifty percent of qualified wages in the first year of employment.
- Forty percent of qualified wages in the second year of employment.
- Thirty percent of qualified wages in the third year of employment.
- Twenty percent of qualified wages in the fourth year of employment.
- Ten percent of qualified wages in the fifth year of employment.

The total amount of qualified wages that may be taken into account for purposes of claiming the credit would be limited to \$2,000,000 per taxable year.

The bill would define the following:

- “Qualified employee” means an individual employed by the qualified taxpayer during the taxable year in the water technology and innovation zone.
- “Qualified taxpayer” means a person or entity that is located in a water technology and innovation zone and engages in either of the following:
 - Water resource management research or education.
 - Water efficiency, recycling, conservation, treatment, or supply technology research or manufacturing.
- “Qualified wages” means that portion of wages paid or incurred by the qualified taxpayer during the taxable year to qualified employees that does not exceed 150 percent of the minimum wage.
- “Water innovation and technology zone” means the City of Oroville.

Unused credits may be carried over for up to two years.

Any deduction otherwise allowed would be reduced by the amount of this credit. Any other wage based credit otherwise allowed would be unaffected by the credit this bill would allow.

The credit would be excluded from the requirements of 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.

This bill uses a term that is undefined, i.e., "water technology and innovation zone." The absence of definitions to clarify this term 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 definitions of "qualified taxpayer" and "qualified employee" may be more broadly defined than the author intended. As written, all wages of all qualified employees may be included in the credit and could include janitors, office staff, management, etc. If this is contrary to the author's intent, the bill should be amended.

Typically, credits involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language would specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

Because the bill fails to specify otherwise, the \$2,000,000 cap specified would apply to each taxpayer per taxable year. Additionally, because the bill lacks language to the contrary, each member of a combined report could generate a credit on up to \$2,000,000 in qualified wages paid per taxable year. If this is contrary to the author's intent, the bill should be amended.

The bill allows a credit for 150 percent of minimum wage of wages paid to qualified employees by a qualified taxpayer. However, it is unclear if the wages paid over the 150 percent cap should count toward the \$2,000,000 cap. For clarity, it is recommended that the bill be amended.

This credit is not restricted to newly hired employees only. As a result, employees that were already employed by the taxpayer prior to the enactment of this bill would qualify for the credit and it is unclear which rate an employer should use in which year. For example, if an employee is hired in 2017, but the credit is not available until 2019, should the employer use 50 percent of wages paid as the multiplier for the 1st year of credit or 30 percent for the 3rd year of employment. It is recommended the bill be amended to add clarity.

The bill lacks language to prevent a qualified taxpayer from releasing employees after their 5th year of employment, and then re-hiring an employee simply to claim the credit again for the 1st year. If this is contrary to the author's intent, the bill should be amended.

Further, the bill lacks language that would prevent a qualified taxpayer from moving an employee to another member of the combined group and claiming the move as a "new hire date." If this is contrary to the author's intent, the bill should be amended to add language to treat each combined group as a single taxpayer.

Technical Considerations

For consistency, the reference to “qualified employer” on page 5, line 28, should be modified to “qualified taxpayer”.

To clarify the author’s intent, the author may wish to modify the definition of “qualified taxpayer” to refer “taxpayer” instead of “person,” which is more widely defined in the code.

Legislative History

AB 1586 (Gallagher, 2017/2018), would have created a tax credit for certain taxpayers that employ employees that have little to no functional hearing. AB 1586 failed to pass out of the house of origin by the constitutional deadline.

AB 1904 (Cervantes, 2017/20018) would create a tax credit in an amount equal to \$1 for each hour a registered apprentice worked during the taxable year up to \$1,000 for each registered apprentice. AB 1904 is currently pending before the Assembly Appropriations Committee.

AB 1629 (Maienschein, 2017/2018) would have allowed a credit for employers that hire employees eligible to be paid a special minimum wage and pay them at or above the minimum wage. AB 1629 failed to pass out of the house of origin by the constitutional deadline.

AB 585 (Melendez, 2015/2016) would have allowed a tax credit for water-efficient improvements to outdoor landscapes. AB 585 failed to pass out of the Assembly by the constitutional deadline.

AB 603 (Salas, 2015/2016) would have allowed a credit to a taxpayer participating in a lawn replacement program in an amount equal to \$2 per square foot of conventional lawn removed from the taxpayer’s property. AB 603 failed to pass out of the Assembly by the constitutional deadline.

AB 2434 (Gomez, Chapter 738, Statutes of 2014) excludes from gross income, under both the PITL and CTL, amounts received as a rebate, voucher, or other financial incentive issued by a local water agency for participation in a turf removal water conservation program. The exclusion will be in effect for taxable years 2014 through 2018.

AB 2537 (Grove, 2013/2014), would have allowed a tax credit equal to 25 percent of a taxpayer’s qualified costs to install one or more water-conserving plumbing fixtures, not to exceed \$2,500 per taxable year. This bill failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

Other States’ Information

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were selected 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 2957 as Amended March 20, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

(Dollars)

Fiscal Year	Revenue
2018-2019	- \$70,000
2019-2020	- \$200,000
2020-2021	- \$250,000

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

The revenue impact of this bill would depend on the number of employees hired by "qualified taxpayers in the City of Oroville in the five years prior to and including 2019, the number hired in 2019 and the years following. Based on information from the U.S. Census Bureau, there were less than 100 employees working for "qualified taxpayers" in 2015. Based on the same source, it was assumed that under the current law, five qualifying employees were hired each year from 2015 to 2019. It was further assumed, that, beginning in 2019, four new employees would be hired each year for a total 20 new employees over five years due to the incentive effect of this bill. Using a minimum hourly wage of \$11 for 2019, these hires generated estimated credits totaling approximately \$300,000. Corporations would apply approximately \$110,000 in credits against their tax liability in the 2019 taxable year and the remaining amount would be carried forward to the subsequent two years. Because taxpayers would continue to generate credits and their average tax liability is less than the credits generated, they would be unlikely to use the carryover the first five years.

Because of the broad definition of a "qualified taxpayer," the credits generated were increased by 30 percent, or \$90,000, for other taxpayers that may claim the credit. It was assumed that approximately 70 percent, or \$60,000, would be used in the year generated and the remaining amount would be carried forward to the subsequent two years.

To arrive at the offsetting tax effect of wage expense deductions that would be otherwise allowed under current law, the credit amount is multiplied by the tax rate of 8.8 percent for C corporations and 1.5 percent for S corporations for an offsetting revenue gain of about \$30,000. This results in a net revenue loss of \$150,000 in the 2019 taxable year increasing to \$350,000 in 2023.

This estimate assumes a “water technology and innovation zone” is the same as a “water innovation and technology zone” as defined in the bill.

The tax-year estimates are converted to fiscal-year estimates, and then rounded to arrive at the estimates shown in the above table.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some may argue that this bill would incentive job growth in the water resource industry within a water technology and innovation zone.

Opponents: Some may argue that this credit is overly narrow and should be allowed without regard to being located in a water technology and innovation zone.

Policy Concerns

This bill would provide a tax benefit for those taxpayers subject to the CTL that would not be provided to other business entities subject to the Personal Income Tax Law. Thus, this bill would provide differing treatment based solely on classification.

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 in certain circumstances to claim multiple tax credits for the same wages paid.

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