



Summary Analysis of Amended Bill

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Sponsor:

Bill Number: AB 2957

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Amended: May 1, 2018

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Related Bills: See Prior Analysis

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 May 1, 2018, amendments modified the operative date of the bill, language preventing a double benefit for the same wages paid, and the Regents of the University of California's responsibilities under this bill. As a result of the amendments, two of the policy concerns and the technical considerations provided in the department's analysis of the bill as amended April 16, 2018, have been resolved and a new implementation consideration has been identified. Except for the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Technical Considerations," "Economic Impact," and "Policy Concerns" sections, the remainder of that analysis still applies. The outstanding implementation considerations and policy concern and the "Fiscal Impact" section are restated below for convenience.

Effective/Operative Date

This bill would be effective January 1, 2019, and specifically operative for the five consecutive taxable years beginning on or after the first January 1, after the Regents of the University of California establish the California Institute for Water Innovation and Technology within the City of Oroville or the County of Butte downstream of Lake Oroville and post the notice as described in subdivision (b) of Section 92990 of the Education Code.

This Bill

This bill would, under the CTL, contingent upon specified activities being taken by the Regents of the University of California, allow for the five consecutive taxable years beginning on or after the first January 1, after the specified activities occur, 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 innovation and technology 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 or areas within 10 miles downstream of Lake Oroville.

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

No other credit or deduction would be allowed with respect to the amounts paid or incurred by a qualified taxpayer for qualified wages paid or incurred by the qualified taxpayer to qualified employees that are taken into account in computing this credit.

The credit would be excluded from the requirements of Section 41.

This credit shall become operative on the first January 1, occurring after the date the Regents of the University of California establish the California Institute for Water Innovation and Technology within the City of Oroville or in the County of Butte downstream of Lake Oroville and post the notice as described in subdivision (b) of Section 92990 of the Education Code.

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,” while the definition reverses the terms: “water innovation and technology zone.” The inconsistent terminology 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,” “10 miles downstream,” “water resource management or education,” “water efficiency, recycling, conservation, treatment, or supply technology research or manufacturing,” and “qualified employee” may be more broadly interpreted than the author intended. The author may wish to amend the bill to provide definitions.

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 first year of credit or 30 percent for the third 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 fifth year of employment, and then re-hiring an employee simply to claim the credit again for the first 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.

It is unclear how taxpayers and the department would be notified that the activities required to trigger the operative date had occurred. For clarity and ease of administration, the author may wish to amend the bill.

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 May 1, 2018
Assumed Enactment after June 30, 2018

Fiscal Year	Revenue
2018-2019	- \$80,000
2019-2020	- \$240,000
2020-2021	- \$310,000

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

This estimate assumes that the Regents of the University of California would establish a California Institute of Water Innovation and Technology within the City of Oroville as of January 1, 2019, and would make this credit operative for taxable years beginning on or after January 1, 2019 and for the next five consecutive years. Based on information from the U.S. Census Bureau, there were less than 150 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, six new employees would be hired each year for a total 30 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 \$340,000. The amount of credit used would be limited by the taxpayer's liability. As a result, it is estimated that corporations would apply approximately \$150,000 in credits against their tax liability in the 2019 taxable year. Because taxpayers would continue to generate new credits each year and their average tax liability would be less than the credits generated, it is unlikely that any carryover would be used in the first five years.

Because of the broad definition of a "qualified taxpayer," the credits generated were increased by 30 percent, or \$100,000, for other taxpayers that may claim the credit. It was assumed that approximately 70 percent, or \$70,000, 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 \$40,000. This results in a net revenue loss of \$200,000 in the 2019 taxable year increasing to \$450,000 in 2023. This estimate assumes the taxpayer does not claim any other credits with respect to the “qualified wages” used to compute this credit.

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.

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.

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