



Analysis of Amended Bill

Author: Arambula

Sponsor:

Bill Number: AB 3029

Analyst: Jessica Deitchman

Phone: (916) 845-6310

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Attorney: Bruce Langston

Related Bills: See Legislative
History

Subject: California New Employment Credit/FTB Report Annually to Legislature Regarding Credit

Summary

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), amend the existing New Employment Credit (NEC) and create the California New Employment Credit (California NEC).

Recommendation – No position.

Summary of Amendments

The March 20, 2018, amendments removed 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 the bill is to provide an incentive to California employers to hire employees and increase overall employment in this state.

Effective/Operative Date

As a tax levy, the bill would be effective upon enactment.

The modifications to the existing NEC would be operative immediately, and the provisions adding the California NEC would be specifically operative for each taxable year beginning on or after January 1, 2019, and before January 1, 2024.

State Law

For taxable years beginning on or after January 1, 2014, and before January 1, 2021, current state law allows a 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. The qualified taxpayer must receive a tentative credit reservation from the Franchise Tax Board (FTB) for that qualified full-time employee. Additionally, the FTB must provide a searchable database on its website reporting the name of the person or entity claiming the credit, the total amount of credit claimed, and the number of new jobs created.

This Bill

This bill would remove from the existing NEC, the FTB's responsibility to provide a searchable database on its website.

Additionally, for each taxable year beginning on or after January 1, 2019, and before January 1, 2024, this bill would, under the PITL and CTL, create a California NEC that would be available to a qualified taxpayer that hires a qualified full-time employee and pays or incurs qualified wages. The qualified taxpayer must receive a tentative credit reservation from the FTB, as specified, for that qualified full-time employee.

"Qualified taxpayer" would mean a person or entity (under the PITL) or a corporation (under the CTL) engaged in a trade or business in the state that during the taxable year pays or incurs qualified wages. Qualified taxpayer would specifically exclude:

- Code 561320 Temporary Help Services.
- Code 713210 Casinos (except Casino Hotels).
- Code 721120 Casino Hotels.
- Code 722410 Drinking Places (Alcoholic Beverages).
- An employer that is a "sexually oriented business", defined as a nightclub, bar, restaurant, or similar commercial enterprise that provides for an audience of two or more individuals live nude entertainment or live nude performances where the nudity is a function of everyday business operations and where the nudity is a planned and intentional part of the entertainment performance.

"Qualified full-time employee" would mean an individual who meets all of the following requirements:

- Receives starting wages that are at least 100 percent of the minimum wage, and
- Is hired by the qualified taxpayer on or after January 1, 2019.

In addition, the qualified full-time employee must satisfy either of the following conditions:

- Is paid qualified wages by the qualified taxpayer for services not less than an average of 35 hours per week, or
- Is a salaried employee and was paid compensation during the taxpayer year for full-time employment, within the meaning of Labor Code section 515, by the qualified taxpayer.

Upon commencement of employment with the qualified taxpayer, the qualified employee must satisfy any of the following conditions:

- Was unemployed^{1,2} for the six months immediately preceding commencement of employment with the qualified taxpayer.
- An individual is “unemployed” for any period for which the individual is all of the following:
 - Not in receipt of wages subject to withholding³ for that period.
 - Not a self-employed individual⁴ for that period.
 - Not a registered full-time student at a high school, college, university, or other postsecondary educational institution for that period.
- Is a veteran who separated from service in the Armed Forces of the United States within the twelve months preceding commencement of employment with the qualified taxpayer.
- Was a recipient of the federal earned income tax credit for the previous taxable year.
- Was an ex-offender previously convicted of a felony.
- Is a recipient of either CalWORKs, in accordance with Article 2 (commencing with section 11250) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code, or general assistance, in accordance with section 17000.5 of the Welfare and Institutions Code.

An individual may be considered a qualified full-time employee only for the period of time commencing with the date the individual is first employed by the qualified taxpayer and ending 24 months thereafter.

“Qualified wages” would mean those wages that are subject to withholding⁵ that meet all of the following requirements:

- That portion of wages paid or incurred by the qualified taxpayer during the taxable year to each qualified full-time employee that exceeds 100 percent of minimum wages, but does not exceed 350 percent of minimum wage.

¹ An individual is “unemployed” for any period of time in which an individual is not in receipt of wages subject to state withholding, and not self-employed, and not a registered full-time student at a high school, college, university, or other postsecondary educational institution for that period.

² In the case of an individual that has completed a program of study at a college, university, or other postsecondary educational institution, received a baccalaureate, postgraduate, or professional degree, and was unemployed for six months immediately preceding employment with the qualified taxpayer, that individual must have completed that program of study at least 12 months prior to the individual’s commencement of employment with the qualified taxpayer.

³ Under Section 13020 of the Unemployment Insurance Code.

⁴ Within the meaning of Section 401(c)(1)(B) of the Internal Revenue Code.

⁵ Under Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.

- Wages paid or incurred during the 24-month period beginning with the first day the qualified full-time employee commences employment with the qualified taxpayer. In the case of any employee who is reemployed, including a regularly occurring seasonal increase, in the trade or business operations of the qualified taxpayer, this reemployment shall not be treated as constituting commencement of employment.

“Seasonal employment” would mean employment by a qualified taxpayer that has regular and predictable substantial reductions in trade or business operations.

The amount of the California NEC allowable for a taxable year would be equal to the product of the “tentative credit amount” for the taxable year and the “applicable percentage” for that taxable year.

- The “tentative credit amount” for the taxable year would be equal to the product of the “applicable credit percentage” for each qualified full-time employee and the qualified wages paid by the qualified taxpayer during the taxable year to that qualified full-time employee.
- The “applicable percentage” for a taxable year would be equal to a fraction, the numerator of which is the net increase in the total number of full-time employees employed in the state during the taxable year, determined on an annual full-time equivalent basis, as compared with the total number of full-time employees employed in the state during the base year, the denominator would be the total number of qualified full-time employees employed in the state during the taxable year. The applicable percentage may not exceed 100 percent.
 - “Base year” would mean the 2018 taxable year, except in the case of a qualified taxpayer who first hires a qualified full-time employee in a taxable year beginning on or after January 1, 2020, the base year would mean the taxable year immediately preceding the taxable year in which a qualified full-time employee was first hired by the qualified taxpayer.
- The “applicable credit percentage” would mean the credit percentage for the calendar year during which a qualified full-time employee was first employed by the qualified taxpayer. Unless otherwise specified in the Budget Act, the applicable credit percentage for each taxable year beginning on or after January 1, 2019, would be 0 percent.
- “Annual full-time equivalent” would mean either of the following:
 - In the case of a full-time employee paid hourly qualified wages, “annual full-time equivalent” means the total number of hours worked for the qualified taxpayer by the employee, not to exceed 2,000 hours per employee, divided by 2,000.
 - In the case of a salaried full-time employee, “annual full-time equivalent” means the total number of weeks worked for the qualified taxpayer by the employee divided by 52.

- “Applicable minimum wage” would mean the wage established pursuant to Chapter 1⁶ of Part 4 of Division 2 of the Labor Code or the local minimum wage of any city or city and county, whichever is higher, for the period during which the qualified wages are paid or incurred by the qualified taxpayer.

The “net increase in full-time employees” would be determined as follows:

- On an annual full-time equivalent basis, by subtracting the total number of full-time employees employed in the base year by the qualified taxpayer from the total number of full-time employees employed in the current taxable year by the qualified taxpayer.
- For taxpayers who first commence doing business in this state during the taxable year, the number of full-time employees for the base year would be zero.

To be eligible for the credit a qualified taxpayer shall, upon hiring a qualified full-time employee, request a tentative credit reservation from the FTB within 30 days from the commencement of employment, in a form and manner prescribed by the FTB. To obtain a tentative credit reservation a taxpayer shall provide necessary information to the FTB, including the name, social security number, the start date of employment, the rate of pay of the qualified full-time employee, the qualified taxpayer’s gross receipts from the previous taxable year, and whether the qualified full-time employee is a resident of a targeted employment area. A tentative credit reservation provided by the FTB to the qualified taxpayer would not constitute a determination by the FTB with respect to any of the requirements regarding a qualified taxpayer’s eligibility for the California NEC.

The FTB would be required to do the following:

- Approve a tentative credit reservation request with respect to a qualified full-time employee hired during the calendar year.
- Determine the aggregate tentative reservation.
- Expeditiously process tentative credit reservation requests regarding qualified full-time employees that reside in a targeted employment area.

All employees of trades or businesses that are treated as related under sections 267, 318 or 707 of the Internal Revenue Code would be treated as employed by a single taxpayer. All employees of trades or businesses that are unincorporated, and that are under common control, shall be treated as employed by a single taxpayer. The credit allowable by this section with respect to each trade or business would be determined by reference to its proportionate share of the expense of the qualified wages giving rise to the credit, and would be allocated in that manner. Principles that apply in the case of controlled groups of corporations⁷ would apply with respect to determining employment.

⁶ Commencing with section 1171.

⁷ As specified in subdivision (h) of Section 23626 of the Revenue and Taxation Code.

If an employer acquires⁸ the major portion of a trade or business of another employer (hereinafter predecessor) or the major portion of a separate unit of a trade or business of a predecessor, then for any taxable year ending after that acquisition, the employment relationship between a qualified full-time employee and an employer would not be treated as terminated if the employee continues to be employed in that trade or business.

The credit claimed by a qualified taxpayer in regard to a qualified full-time employee may be recaptured and assessed in the same manner as a mathematical error for the taxable year of termination if the qualified full-time employee is terminated by the qualified taxpayer at any time during the first 12 months, after commencing employment, whether or not consecutive, with the qualified taxpayer, unless any of the following occur:

- The qualified full-time employee voluntarily leaves the employment of the qualified taxpayer.
- The qualified employee becomes disabled and unable to perform the services of employment.⁹
- The qualified employee was terminated for misconduct.¹⁰
- The termination was due to a substantial reduction in the trade or business operations of the taxpayer, including reductions due to seasonal employment.
- The terminated qualified employee is replaced by other qualified full-time employees so as to create a net increase in both the number of employees and the hours of employment.
- The termination of employment of the qualified full-time employee, when that employment is considered seasonal employment and the qualified employee is rehired on a seasonal basis.

The employment relationship between the qualified taxpayer and a qualified full-time employee shall not be treated as terminated by reason of a mere change in the form of conducting the trade or business of the qualified taxpayer if the qualified full-time employee continues to be employed in that trade or business and the qualified taxpayer retains a substantial interest in that trade or business.

The FTB would be required to:

- Report the total amount of credits claimed to the Department of Finance on a monthly basis.
- Annually provide to the Joint Legislative Budget Committee, by no later than March 1, a report of the total dollar amount of credits claimed with respect to that fiscal year with

⁸ "Acquired" includes any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

⁹ Unless the qualified taxpayer fails to offer reemployment of that employee if the disability is removed.

¹⁰ As defined in Sections 1256-30 to 1256-43 of Title 22 of the California Code of Regulations.

the department's estimate for that fiscal year. If the total dollar amount of credits claimed for the fiscal year is less than the estimate for that fiscal year, the report shall identify options for increasing annual claimed of the credit so as to meet estimated amounts.

Upon the effective date of this section, the Department of Finance would be required to estimate the total dollar amount of the California NEC that will be claimed with respect to each fiscal year from the 2019-20 fiscal year to the 2023-24 fiscal year, inclusive.

This credit may be carried over to reduce the net tax for up to 5 years, until exhausted. This credit may only be claimed on a timely filed original return of the qualified taxpayer and only with respect to a qualified full-time employee for whom the qualified taxpayer received a tentative credit reservation.

This section shall remain in effect only until December 1, 2024, and as of that date would be repealed. However, for taxable years beginning on or after January 1, 2024, the credit would remain available for any qualified taxpayer with respect to any otherwise qualified full-time employee for the remaining period of the 24-month period after the original date of hiring.

This credit shall be known and cited as the "California New Employment Credit."

The bill addresses the provisions of Section 41 in off-code language with the following:

The FTB would be required to annually prepare a written report to measure whether the credit achieves its intended purpose. The report would contain the following information:

- The number of tax returns claiming the credit.
- The number of employees represented on the tax returns claiming the credit.
- The distribution of newly hired employees over the five different employment-disadvantaged categories.
- The average credit amount on tax returns claiming the credit.
- The average credit amount per employee on tax returns claiming the credit.

On or before ___ and each ___ thereafter, while this bill is in effect, the FTB would be required to provide the written report to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Governance and Finance, and the Assembly Committees on Revenue and Taxation.

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 require the department to provide a report to the Legislature on the performance of this credit. The credit is currently calculated on a "full-time equivalent" basis and measures the increase as an "overall net increase" and does not track individual employees. Because the specified structure of the credit as provided in this bill, the department and the taxpayer

would have not have the information available to provide information in the report relating to “the distribution of newly hired employees over the five different employment-disadvantaged categories.” It is recommended that the bill be amended to remove this requirement.

Technical Considerations

To avoid confusion, it is recommended that the credit in the bill be renamed the “California Hiring Credit.”

For clarity on which minimum wage should apply, on page 16, line 38 and page 38, line 16, after the first instance of “city,” insert “or county,”

Because the credit being created is for employment within the whole state, recommend striking:

Page 20, line 24, after “year” through line 27;

Page 21, line 1-9;

Page 42, line 2, after “year” through line 5; and

Page 42, line 19-27.

The bill would require the FTB to provide reports to the Legislature by an unspecified deadline. It is recommended the bill be amended to fill in the required dates.

Legislative History

AB 1629 (Maienschein, et al., 2017/2018) 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. The credit would have been in an amount equal for the difference between the special minimum wage that may be paid to a qualified employee and the minimum wage. AB 1629 failed to pass out of the house of origin by the constitutional deadline.

SB 661 (Fuller, 2017/2018) would have expanded the NEC by adding a new type of qualified employee. SB 661 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. The credit would have been in an amount equal for the difference between the special minimum wage that may be paid to a qualified employee and the minimum wage. 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.

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 (CCC) Committee, and created the CCC under the PITL and CTL.

Other States' Information

Review of *Illinois, Florida, 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

This bill would require some changes to the existing tax forms and instructions, and information systems. As the bill continues to move 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 3029 as Amended March 20, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue*
2018-2019	- \$12
2019-2020	- \$32
2020-2021	- \$41

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.

*The applicable credit percentage for purposes of this estimate is assumed to be 35 percent unless otherwise specified in the Budget Act.

Revenue Discussion

The estimated revenue loss associated with the California NEC is based on economic forecasts and demographic data from the Department of Finance and current hiring credit data from the FTB. Based on an analysis of current hiring credit usage it is estimated that employers would use \$5.1 million in the California NEC in 2019 within designated census tracts or economic development areas currently impacted by the NEC. A further 20 percent adjustment is made in 2019, 2020, and 2021 to account for employees in these areas which would qualify under both the current NEC and the new hiring credit. A transition adjustment is made in taxable year 2021, to account for new hires that would have qualified for the current NEC, but because the credit sunsets, employers would now claim the California NEC. For the remainder of qualified taxpayers within the state, it is estimated that they would use \$16 million in California NEC in taxable year 2019. This results in total credits claimed of \$22 million in taxable year 2019 and \$41 million in taxable year 2020.

The tax-year estimates are converted to fiscal-year estimates then rounded to arrive at the amounts reflected in the above table.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some may argue that this bill would encourage hiring of difficult-to-employ individuals.

Opponents: Some may argue that this credit is overly complicated and could be underutilized.

Policy Concerns

This bill could allow taxpayers in certain circumstances to claim multiple credits for the same wages paid.

Legislative Staff Contact

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310
jessica.deitchman@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov