

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Kiley & Obernolte Analyst: Jon Feenstra Bill Number: AB 656
Related Bills: See Legislative History Telephone: 845-4870 Introduced Date: February 14, 2017
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Employer Federal Unemployment Insurance Tax Credit

SUMMARY

This bill would, under the Personal Income Tax Law and the Corporation Tax Law, provide a tax credit for certain employers that paid federal unemployment insurance tax.

RECOMMENDATION - NO POSITION

REASON FOR THE BILL

The reason for the bill is to create a tax credit to reduce the burden on taxpayers of paying a higher federal unemployment insurance tax due to state loans from the federal government to fund the state’s unemployment insurance benefits.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2017.

FEDERAL/STATE LAW

Unemployment Insurance Taxes

Unemployment Insurance (UI) is a federal-state program jointly financed through federal and state employer payroll taxes. Generally, employers must pay both state and federal unemployment taxes if: (1) they pay wages to employees totaling \$1,500, or more, in any quarter of a calendar year; or (2) they had at least one employee during any day of a week during 20 weeks in a calendar year, regardless of whether or not the weeks were consecutive.

Federal Unemployment Tax Act

The Federal Unemployment Tax Act (FUTA), authorizes the Internal Revenue Service (IRS) to collect a federal employer tax used to fund state workforce agencies. Employers pay this tax annually by filing IRS Form 940.¹ FUTA covers the costs of administering the UI and job service programs in all states. In addition, FUTA pays one-half of the cost of extended unemployment benefits (during periods of high unemployment) and provides for a fund from which states may borrow, if necessary, to pay benefits.

¹ Form 940, Employer’s Annual Federal Unemployment (FUTA) Tax Return.

Federal Unemployment Tax Rate

FUTA taxes are calculated by multiplying 6.0 percent times the employer's taxable wages. The taxable wage base is the first \$7,000 paid in wages to each employee during a calendar year. Employers who pay their state unemployment taxes on a timely basis receive an offset credit of up to 5.4 percent regardless of the rate of tax paid to the state.

FUTA State Credit Reduction

A state is a "credit reduction state" if it has taken loans from the federal government to meet its state unemployment benefits liabilities and has not repaid the loans within the allowable time frame. A reduction in the usual credit against the full FUTA tax rate means that employers paying wages subject to UI tax in those states will owe a greater amount of tax.

If a state has outstanding loan balances on January 1 for two consecutive years, and does not repay the full amount of its loans by November 10 of the second year, the FUTA credit rate for employers in that state will be reduced until the loan is repaid.

The reduction schedule is 0.3 percent for the first year the state is a credit reduction state, another 0.3 percent for the second year, and an additional 0.3 percent for each year thereafter that the state has not repaid its loan in full. Additional offset credit reductions may apply to a state beginning with the third and fifth taxable years if a loan balance is still outstanding and certain criteria are not met.

The United States Department of Labor (DOL) administers the state loan program and announces any credit reduction states after the November 10 deadline each year. California had state loan balances as of November 10, 2016, and receives a credit reduction of 1.8 percent² for 2016 unemployment tax.

California State Unemployment Tax

California has a state unemployment insurance tax that is administered by the Employment Development Department (EDD). The California unemployment insurance tax is part of the FUTA program described above, but it is administered separately by the state.

THIS BILL

This bill would for each taxable year beginning on or after January 1, 2017, allow a credit to a taxpayer that is an employer paying the federal unemployment insurance tax in an amount equal to the reduction in the amount of state unemployment tax credit applied against federal unemployment insurance tax during the taxable year.

The credit must be claimed on the taxpayer's timely filed original return.

² DOL, Division of Fiscal and Actuarial Services.

Unused credits may be carried forward for up to eight years from the year in which the credit was incurred, or until exhausted, whichever occurs first.

Any deduction otherwise allowed for any amount paid or incurred by the qualified taxpayer upon which the credit is based would be reduced by the amount of the credit allowed.

Because the bill fails to specify otherwise, this credit would not reduce regular tax below the tentative minimum tax for alternative minimum tax purposes.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill uses terms that are undefined, i.e., "employer," "qualified taxpayer," "federal unemployment insurance tax," and "state unemployment tax credit." The absence of definitions to clarify these terms 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.

This bill does not specify the federal unemployment insurance tax or state unemployment state reduction amounts to be used to determine the state tax credit. It is recommended that this bill be amended to add the word "due" after the word "tax" on page 2, line 8.

It is unclear how the department would verify the reduction in the amount of state unemployment tax credit applied against federal unemployment insurance tax during the taxable year. 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.

TECHNICAL CONSIDERATIONS

For internal consistency within the Revenue and Taxation Code, the phrases "as defined by Section 17039" and "as defined by Section 23036" should be enclosed in parenthesis.

LEGISLATIVE HISTORY

Research of California legislation found no legislation similar to the provisions of this bill.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable tax credit. 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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 656 As Introduced February 14, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$2,100	- \$1,400	- \$550

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 EDD, the estimated FUTA credit reduction paid by taxpayers would be \$2.2 billion in taxable year 2017, and \$2.6 billion in taxable year 2018. The EDD estimates that California would pay off its unemployment insurance deficit in 2018. It is estimated that 65 percent, or \$1.4 billion, of the credit would be used in the year generated and the remaining 35 percent would be used over the next several years. Taxpayers must reduce their deductions by the credit amount. In taxable year 2017, an offsetting gain of \$140 million is applied to account for the decrease in reported deductions.

The tax year estimates are converted to fiscal year estimates, and then rounded and reflected in the above table.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that employers that pay the unemployment insurance tax should not bear the burden of paying higher amounts due to borrowing by the state.

Opponents: Some may argue that there is a more suitable way to alleviate the impact of an employment related tax regime than creating a new tax credit under the income and franchise tax law.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

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