SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a tax credit to a qualified small business for costs paid or incurred with regard to compliance with state regulations and law.

RECOMMENDATION – NO POSITION

SUMMARY OF AMENDMENTS

The March 20, 2017, amendments added a coauthor, clarifying language, and a $5,000 credit amount, at the election of the taxpayer. As a result of the amendments, one of the “Implementation Considerations” in the department’s analysis of the bill as introduced February 16, 2017, has been addressed. Except for the “This Bill,” and “Economic Impact” sections, the remainder of that analysis still applies. The remaining “Implementation Considerations,” “Fiscal Impact,” and “Policy Concerns” sections have been restated for convenience.

THIS BILL

For each taxable year beginning on or after January 1, 2017, this bill would, under the PITL and CTL, allow a tax credit to a qualified small business for costs paid or incurred during the taxable year with regard to compliance with state laws and regulations in an amount equal to either, as elected by the taxpayer:

- Five thousand dollars ($5,000), or
- $25 per each person-hour spent on compliance with state laws and regulations.

The bill would define the following:

- “Compliance with state laws and regulations” means the adherence to laws, regulations, guidelines, and specifications relevant to the taxpayer’s business and includes, but is not limited to, preparation for, and the providing of, mandatory training for employees, modification of the business premises, and providing required information regarding employee safety.

- “Qualified small business” means a business that:
  - Is independently owned and operated.
  - Is not dominant in its field of operation.
- Has fewer than 100 employees.
- Averages annual gross receipts of $15,000,000 or less over the previous three taxable years.

Unused credits could be carried over for seven years or until exhausted.

The provisions of Section 41 would be inapplicable to the credit allowed by this section.

**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 phrases that are undefined, i.e., “independently owned and operated,” “person-hour,” “not dominant in its field of operation,” and “compliance with state laws and regulations.” The absence of definitions to clarify these phrases could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended the bill be amended to clearly define these phrases.

The bill specifies that to qualify as a “qualified small business” the business must “have fewer than 100 employees.” However, the bill fails to specify when the 100 employee count must not be exceeded. It is recommended the bill be amended to specify when the employee count should occur or if the business can never exceed 100 employees during the tax year to keep its qualification as a small business.

The bill also specifies a “qualified small business” averages annual gross receipts of $15 million or less over the previous three taxable years. How does this apply to new businesses or recently moved from out of state businesses? What is the measure of “gross receipts” for the purposes of this section? Only those “gross receipts” reportable to this state? It is recommended the bill be amended to specify what “gross receipts” means.

**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.

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1 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.
ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

<table>
<thead>
<tr>
<th>Estimated Revenue Impact of AB 831</th>
</tr>
</thead>
<tbody>
<tr>
<td>As Amended on March 20, 2017</td>
</tr>
<tr>
<td>Assumed Enactment After June 30, 2017</td>
</tr>
<tr>
<td>($ in Billions)</td>
</tr>
<tr>
<td>2017-18</td>
</tr>
<tr>
<td>- $18</td>
</tr>
</tbody>
</table>

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 the US Small Business Administration and the Franchise Tax Board, there are an estimated 3.2 million small businesses that would qualify for the credit in 2017. Due to the timing of this bill, it is assumed that 80 percent, or 2.5 million businesses, would claim the credit in the first year and 100 percent would claim the credit each year thereafter.

Based on available research, it is assumed that each eligible business would employ the average equivalent of one full-time employee to work on state compliance laws and regulations. It is assumed the full time-equivalent employee would spend an average of 1,300 hours performing compliance related activities each year. This would result in approximately 3.3 billion person-hours spent on qualified compliance activities. The estimated 3.3 billion hours multiplied by a credit of $25 per hour, results in estimated credit generated of $80 billion in 2017. It is assumed that the per-hour credit calculation would exceed $5,000 and thus be more beneficial to the taxpayer. It is assumed that 10 percent, or $8 billion, of the credit will be used in the year generated and that taxpayers would utilize some of the remaining credits over the next seven years, or until expired. However, taxpayers would continue to generate new credits each year thus accumulating a reserve of credits for future use.

The calendar year estimates are converted to fiscal years and then rounded to arrive at the amounts shown in the above table.
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.

Because wages paid to employees are deductible under current law and may also be eligible under another provision of state tax law for a wage credit, this bill would allow taxpayers to claim multiple tax benefits for the same item of expense.

Generally, credits are limited as a percentage of amounts paid or incurred. This bill would allow a twenty-five dollar credit per man-hour regardless of the amount of the wage paid.

This bill fails to limit the amount of the credit that may be taken. Credits that could potentially be quite costly are sometimes limited either on a per-project or per-taxpayer basis.

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