



Analysis of Amended Bill

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Sponsor:

Bill Number: AB 1169

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Amended March 21, 2019, and
April 23, 2019

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Related Bills: See Legislative
History

Subject: Credit Employer Qualified Wages

Summary

This bill would, under the Personal Income Tax Law (PITL), allow a credit to a qualified employer for wages paid to qualified employees.

This analysis only addresses the provisions of the bill that impact the department's programs and operations.

Recommendation – No position.

Summary of Amendments

The March 21, 2019, amendments removed provisions of the bill related to the Welfare and Institutions Code and replaced them with the provisions discussed in this analysis.

The April 23, 2019, amendments added sunset provisions and Revenue and Taxation Code (R&TC) section 41 reporting and evaluation requirements.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for the bill is to encourage employers to hire individuals with disabilities by offering a tax credit.

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, 2020, and before January 1, 2025.

Program Background

The federal Fair Labor Standards Act authorizes employers, after receiving a certificate from the Wage and Hour Division of the Federal Department of Labor, to pay a "special minimum wage" to individuals whose earning or productive capacity is impaired by age, physical or mental deficiency, or injury. A special minimum wage is less than the federal minimum wage and is determined on a case by case basis.

Federal/State Law

Current federal and state 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.

The Work Opportunity Tax Credit (WOTC) is a federal income tax credit available to employers who hire and retain veterans and individuals from targeted groups with significant barriers to employment, including individuals that are qualified Supplemental Security Income (SSI) recipients and individuals with a vocational rehabilitation referral. There is no limit on the number of individuals an employer can hire to qualify to claim the WOTC. Employers are required to obtain certification on or before the beginning work date.

The amount of the WOTC employers may claim varies based on the target group of the individual hired, the wages paid to that individual in the first year of employment, and the number of hours that individual worked. There is a maximum amount of WOTC that can be earned for each targeted group. The credit is unavailable for wages paid to employees that begin work after December 31, 2019.

Current state law allows, before January 1, 2026, the New Employment Credit (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. The qualified employee must meet any of certain conditions, including previous unemployment, veteran status, low income status, ex-offender convicted of a felony, or recipient of specified government assistance.

Under R&TC 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.

This Bill

This bill would, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, allow a tax credit equal to 40 percent of the amount that is paid or incurred by a qualified taxpayer during the taxable year for qualified wages of qualified employees limited to \$6,000 per qualified employee.

The following definitions would apply for purposes of the credit:

- “Qualified employee” means an employee that meets both of the following requirements:
 - Was hired on or after January 1, 2019, and
 - Is one of the following:
 - A vocational rehabilitation referral;
 - A qualified SSI recipient; or
 - A qualified Social Security Disability Insurance (SSDI) recipient.
- “Qualified SSI recipient” means an individual who is receiving SSI benefits under Title XVI of the Social Security Act (including SSI benefits of the type described in Section 1616 of the Social Security Act or Section 212 of Public Law 93-66) for any month ending within 60 days of the hiring date.
- “Qualified SSDI recipient” means an individual who is certified by a designated local agency as receiving SSDI benefits under Section 223 of the Social Security Act for any month ending within 60 days of the hiring date.
- “Qualified taxpayer” means a taxpayer that operates a business and does not hold a certificate pursuant to subsection (c) of Section 214 of Title 29 of the United States Code (U.S.Code) allowing payment of a wage lower than the minimum wage, as specified.
- “Qualified wages” means wages for work performed in California for the first 12 months that a qualified employee is employed by the qualified taxpayer.
- “Vocational rehabilitation referral” means an individual who is certified by the California Department of Rehabilitation (DOR) as having both of the following:
 - A physical or mental disability that constitutes or results in a substantial handicap to employment; and
 - A referral to the employer upon completion of or while receiving rehabilitative services pursuant to any of the following:
 - An individualized written plan for employment under California’s plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973;
 - A program of vocational rehabilitation carried out under Chapter 31 of Title 28 of the U.S. Code; or
 - An individual work plan developed and implemented by an employment network pursuant to Social Security Act, section 1148(g).

Unused credits could be carried over until exhausted.

The Franchise Tax Board (FTB) would be required, on or before March 1, 2021, and annually thereafter, to submit a report to the Legislature, as specified, on the performance of this credit that would include:

- The total dollar amount of the credit claimed;
- A comparison of the total dollar amount claimed to the FTB's prior estimate of the total dollar amount expected to be claimed in that fiscal year;
- The number of qualified taxpayers claiming the credit; and
- The number of qualified employees represented in the credits claimed.

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.

The department lacks the expertise to determine that an employer or employee are qualified for purposes of this credit. 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. The language should also require that the certification be provided to the department upon request.

Because the bill fails to specify otherwise, a qualified employee could be terminated with or without cause and rehired, thus generating qualified wages for more than one 12 month period. If this is contrary to the author's intent, the bill should be amended to specify that qualified wages would be limited to wages paid "within the first 12 months beginning with the qualified employee's initial commencement of employment with the qualified taxpayer."

The FTB's report would be due on or before March 1, 2021, and annually thereafter, as specified. Because income tax returns under the PITL may be filed, with extension, as late as October 15 (October 15, 2021, for the 2020 taxable year) and the department generally processes returns within six months of receipt the initial report, the reports would be based on incomplete data. If the author's intent is that each report contain complete information for the taxable year, the due date of the report should be changed.

This bill would require FTB to compare total credits claimed to prior FTB estimates, which are assumed to be the estimates provided in the revenue table shown below. If this is inconsistent with the author's intent, this bill should be amended.

For ease and speed of implementation it is suggested that the bill be amended to (1) authorize the FTB to issue any regulations necessary or appropriate to implement the purposes of this section, and (2) provide an exemption from the Administrative Procedures Act for any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB with respect to the credit this bill would allow.

Legislative History

AB 1726 (Cervantes, 2019/2020) would allow a tax credit to certain employers that hire employees who are members of a targeted group. AB 1726 is pending before the Assembly Appropriations Committee.

SB 422 (Hueso, 2019/2020) would allow a credit to a qualified employer for wages paid to certain full-time employees. On May 1, 2019, the Senate Committee on Governance and Finance voted to refer SB 422, as amended by that committee, to the Senate Committee on Appropriations.

AB 916 (Quirk-Silva & Arambula, 2017/2018) would have created a California Work Opportunity Tax Credit, similar to the federal credit, with modifications. AB 916 failed to pass by the constitutional deadline.

AB 1216 (Choi, et al., 2017/2018) would have created a credit for certain taxpayers for wages paid to qualified employees. AB 1216 failed to pass by the constitutional deadline.

AB 1586 (Gallagher, 2017/2018) would have created a credit for wages paid to employees that have little to no functional hearing. AB 1586 failed to pass by the constitutional deadline.

AB 2932 (Choi, 2017/2018) would have created a credit for certain taxpayers for wages paid to qualified employees. AB 2932 failed to pass by the constitutional deadline.

AB 2945 (Gallagher, 2017/2018) would have created a credit for wages paid to employees that have little to no functional hearing. AB 2945 failed to pass by the constitutional deadline.

AB 3029(Arambula, 2017/2018) would have created a California new employment credit. AB 3029 failed to pass 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 by the constitutional deadline.

AB 2582 (Maienschein 2015/2016) would have allowed a tax credit for wages paid that were equal to or exceeded the state minimum wage. AB 2582 failed to pass by the constitutional deadline.

Other States' Information

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Illinois allows a credit for qualified wages paid to one or more *Illinois* residents who are qualified ex-offenders. The total credit allowed to a taxpayer is \$1,500 for all taxable years. *Illinois* previously offered credits for wages paid to unemployed veterans and qualified veterans.

New York allows a credit to taxpayers for employing persons with disabilities. The credit is 35 percent of qualified first-year wages, or second-year wages if the federal credit applies. A credit is authorized for qualified employers that employ individuals with developmental disabilities of 15 or 10 percent of qualified wages, and is set to expire on January 1, 2020.

A review of *Massachusetts, Michigan, and Minnesota* law identified no tax credits similar the wage-based credit this bill would allow.

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 1169 as Amended on April 23, 2019
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$1.8
2020-2021	-\$3.6
2021-2022	-\$4.2

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

Based on data from the U.S. Census and Social Security, it is estimated that 1,300 qualified employers would hire qualified employees in the 2020 taxable year. Based on Social Security wage data, it is estimated that these employers would qualify for the maximum credit of \$6,000, resulting in total credit generated of \$8 million. It is estimated that 60 percent would be earned by taxpayers who have a tax liability to offset with the credit. Of that amount, 65 percent, or \$3.1 million, would be claimed in the year generated and the remaining credit would be used over the next several years.

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

Policy Concerns

This bill would provide a tax benefit for sole proprietorships, noncorporate partners of partnerships, limited partnerships, and limited liability companies not electing to be taxed as corporations, limited liability partnerships, and real estate mortgage investment conduits under the PITL that would not be provided to other business entities such as corporations. Thus, this bill would provide differing treatment based solely on classification.

This bill would allow a credit for wages that are currently deductible as business expenses. Generally, a credit is allowed in lieu of a deduction in order to eliminate multiple tax benefits for the same item of expense.

This bill would allow for an unlimited carryover period. Consequently, the department would be required to retain the carryover on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation because experience shows credits typically are exhausted within eight years of being earned.

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