



Analysis of Original Bill

Author: Salas, et al.	Sponsor: None	Bill Number: AB 1842
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SUBJECT

COVID-19 Tax Credit for Small Businesses and Nonprofits / California Competes Tax Credit

SUMMARY

This bill, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL) would do the following:

Provision No.1: Create the COVID-19 Small Business/Nonprofit Tax Credit

Provision No.2: Modify the California Competes Tax Credit (CCTC)

This bill also would make changes to the Food and Agricultural Code, the Government Code, the Health and Safety Code, the Public Resources Code, and the Streets and Highways Code.

This analysis only discusses the provisions that would impact the department's programs and operations.

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

RECOMMENDATION

No position

REASON FOR THE BILL

The reason for this bill is to provide financial relief to small businesses and nonprofit organizations impacted by the COVID-19 pandemic.

ANALYSIS (All Provisions)

Effective/Operative Date (All Provisions)

Assuming enactment by September 30, 2020, this bill would be effective January 1, 2021.

Provision 1 would be specifically operative for taxable years beginning on or after January 1, 2020, subject to an appropriation for the Franchise Tax Board (FTB) to administer the proposed credit.

Provision 2 would be specifically operative for credits allocated beginning with the 2020–2021 fiscal year, subject to an appropriation for the Governor's Office of Business and Economic Development (GO-Biz).

Analysis Provision 1: Create the COVID-19 Small Business/Nonprofit Tax Credit

This Provision

For each taxable year beginning on or after January 1, 2020, this provision would allow an earned income tax credit in an amount equal to up to 20 percent of annual total revenue for a small business or a nonprofit organization impacted by the COVID-19 pandemic.

This provision would define the following terms and phrase as follows:

- "Impacted by the COVID-19 pandemic" means the FTB has certified that the small business or nonprofit has provided sufficient documentation to the FTB that the revenue of the small business or nonprofit has declined due to the economic effects of the COVID-19 pandemic.
- "Nonprofit organization" means a nonprofit organization incorporated pursuant to Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code (The Nonprofit Public Benefit Corporation Law).
- "Small business" has the same meaning as that term is defined in Section 14837 of the Government Code. (See *Appendix A* for additional detail).

The credit allowed by this provision would only be operative for taxable years for which the Legislature appropriates from the General Fund to the FTB moneys to administer the credit.

Effective/Operative Date

This provision would be effective January 1, 2021, and specifically operative for taxable years beginning on or after January 1, 2020, subject to an appropriation by the Legislature for the FTB to administer the proposed credit.

Federal/State Law

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Both federal and state laws provide an earned income tax credit (EITC) for eligible individuals meeting specified requirements. In general, the EITC is a percentage of earned income, which includes, but is not limited to, net-earnings from self-employment, and is phased out as income increases.

For tax year 2019, the maximum income for the federal EITC is \$55,952, and the maximum income for the California EITC is \$30,000. (For additional information see the websites for the Internal Revenue Service (IRS) and the FTB).

There are currently no federal or state credits comparable to the credit this provision would create.

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 lacks administrative details necessary to implement the proposed credit specified in this provision and determine its impacts to the department's systems, forms, and processes. The provision is silent on the following issues:

- The credit percentage is "up to 20 percent." It is unclear under what circumstances the credit percentage would be less than 20 percent.
- The FTB would be required to certify that a small business or nonprofit organization has been "impacted by the COVID-19 pandemic." However, the provision is silent as to the metrics for making that determination including the percent "decline" in revenue.
- It is unclear whether and how often the small business or nonprofit organization would apply to the FTB for certification. Would certification be required for each year the credit is claimed? Or, once certified could the organization claim the credit annually?

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 provision be amended to include a certifying agency.

This provision uses terms and phrases that are undefined, i.e., “annual total revenue,” “impacted,” and “sufficient documentation.” The absence of definitions to clarify these terms and phrases could lead to disputes with taxpayers and would complicate the administration of this provision. For example, the amount of “annual total revenue” could vary significantly depending upon whether it is determined as gross receipts before cost of goods sold or after cost of goods sold. The author may want to amend the bill to clearly define these terms and phrases.

The definition of “nonprofit organization” could be broadly interpreted as it is defined by reference to the Nonprofit Public Benefit Corporation Law. Additionally, being a nonprofit under the Nonprofit Public Benefit Law does not mean that the organization is exempt for California franchise and corporate income tax. If this is contrary to the author’s intent, the author may wish to amend the provision by providing a more specific reference.

Under Revenue and Taxation Code (R&TC) section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit. This provision should be amended to satisfy the R&TC section 41 requirements.

To avoid delayed implementation, it is recommended that the provision be amended to grant the FTB regulatory authority and a waiver from rulemaking procedures required under the Administrative Procedures Act (APA) (under Government Code section 11340 et seq.)

Technical Considerations

To avoid confusion with the existing California earned income tax credit allowed under the PITL, it is recommended that the term “earned income tax credit” be replaced with the term “tax credit.”

Policy Concerns

This provision would provide a tax benefit for small businesses and nonprofit organizations that would not be provided to other businesses or organizations.

This provision does not provide carryover language. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the year claimed. The author may wish to add language allowing a limited carryover period.

This provision does not provide a date by which the credit would become inoperative, commonly referred to as a “sunset date.” Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

LEGISLATIVE HISTORY

Research of California legislation history found no legislation similar to this provision.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department's costs to implement this provision were not determined, but staff anticipates costs could be significant.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB1842 as Amended May 13, 2020
Assumed Enactment after June 30, 2020

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$8,500
2021-2022	-\$4,400
2022-2023	-\$1,900

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

Using FTB data, small businesses are estimated to have revenue of approximately \$835 billion in 2020 taxable year.

It is assumed that 30 percent, or \$225 billion, in revenue would be generated from small businesses or nonprofit entities whose revenue declined due to the economic effects of the COVID-19 pandemic and would be certified in the 2020 taxable year. These revenues are expected to decrease to roughly \$50 billion beginning tax year 2022 as the impact from COVID 19 is expected to decrease over time.

Applying the credit of 20 percent would result in \$45 billion of credit generated in taxable year 2020. It is estimated that 15 percent, or \$7 billion, would be earned by taxpayers who would have sufficient tax liability to claim the credit in the year generated.

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

This revenue estimate assumes that appropriations will be made through the 2024 taxable year.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

Analysis Provision 2: Modify the California Competes Tax Credit

This Provision

This provision, under the PITL and the CTL, would modify the items the Governor's Office of Business and Economic Development (GO-Biz) considers when allocating the CCTC.

Upon appropriation to GO-Biz for the costs of administering this provision, for a credit allocated beginning with the 2020–2021 fiscal year, GO-Biz would be required to consider the overall economic impact in this state of the COVID-19 pandemic to the taxpayer's project or business.

Effective/Operative Date

Assuming enactment by September 30, 2020, this bill would be effective January 1, 2021. This provision would be specifically operative for credits allocated beginning with the 2020–2021 fiscal year, subject to an appropriation for the GO-Biz.

Federal/State Law

Federal law does not include a comparable provision.

State Law

The CCTC is an income or franchise tax credit available to businesses that come to California or stay and grow in California. CCTC agreements are negotiated by GO-Biz and approved by the CCTC Committee (Committee), consisting of the State Treasurer, the Director of the Department of Finance, the Director of GO-Biz (Chair), and one appointee each by the Speaker of the Assembly and Senate Committee on Rules.

Upon approval of the tax credit agreement by the Committee, GO-Biz informs the FTB of the terms and conditions of the written agreement. The FTB reviews the books and records of taxpayers allocated a CCTC to ensure that the taxpayer complied with the terms and conditions of the written agreement. In the case of a small business, the FTB reviews the books and records of the taxpayer if it deems the review appropriate or necessary in the best interest of the state. If the FTB determines that a possible breach of the agreement has occurred, GO-Biz is provided detailed information regarding the basis of the possible breach.

The credit is available for taxable years beginning on or after January 1, 2014, and before January 1, 2030, and will expire on January 1, 2030.

Implementation Considerations

Because this credit is allocated and administered by GO-Biz, the department could make any necessary changes to the forms and systems during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

SB 855 (Committee on Budget and Fiscal Review, Chapter 52, Statutes of 2018), among other changes, extended the CCTC to taxable years beginning before January 1, 2030, and modified the conditions for GO-Biz to consider when allocating this credit.

AB 1716 (Committee on Jobs, Economic Development, and the Economy, 2017/2018), would have extended the CCTC to taxable years beginning before January 1, 2030. AB 1716 failed to pass by the constitutional deadline.

AB 961 (Gallagher, 2015/2016), would have modified the amount of funding for the CCTC. AB 961 failed to pass by the constitutional deadline.

AB 2055 (Gipson, 2015/2016), would have modified the items for GO-Biz to consider when allocating the credit to give special consideration to those installing zero or near-zero emissions equipment. AB 2055 failed to pass by the constitutional deadline.

AB 1560 (Quirk-Silva, et al., Chapter 378, Statutes of 2014), modified the funding for the CCTC.

AB 93 (Assembly Committee on Budget, Chapter 69, Statutes of 2013), among other provisions, created the CCTC.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department's costs to implement this provision were not determined, but staff anticipates cost could be insignificant.

ECONOMIC IMPACT

Revenue Estimate

In accordance with this bill's provision, staff defers to the Department of Finance (DOF) to determine the revenue impact of this provision.

Revenue Discussion

The amount and timing of the CCTC is subject to the written agreements between GO-Biz and the taxpayer. Staff defers to the DOF to determine the revenue impact for this provision.

LEGAL IMPACT

None noted.

APPOINTMENTS

None Noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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Appendix A
Definition of Small Business under Referenced Code Section

Code Section	Definition
GC section 14837	"Small business" means an independently owned and operated business that is not dominant in its field of operation, the principal office of which is located in California, the officers of which are domiciled in California, and which, together with affiliates, has 100 or fewer employees, and average annual gross receipts of ten million dollars (\$10,000,000) or less over the previous three years, or is a manufacturer, as defined, with 100 or fewer employees. Commencing January 1, 2019, the average annual gross receipts threshold shall be fifteen million dollars (\$15,000,000).