STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Dahle	Sponsor:	Bill Number: AB 2041
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SUBJECT

Employer Hiring Credit/Microbusiness First-Time Employee Wage Credit

SUMMARY

This bill would under the Personal Income Tax Law and the Corporation Tax Law establish a credit for qualified wages paid to a qualified employee by a qualified taxpayer that is a microbusiness.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

None noted.

REASON FOR THE BILL

The reason for the bill is to expand employment opportunities for individuals entering the workforce by offering a tax credit to microbusinesses to alleviate the training cost attributable to individuals that have not previously been employed.

ANALYSIS

This bill would for each taxable year beginning on or after January 1, 2021, and before January 1, 2026, allow a tax credit for qualified wages paid or incurred by a qualified taxpayer during the taxable year to a qualified employee.

The amount of the credit would be equal to 30 percent of the amount paid or incurred by a qualified taxpayer during the taxable year for qualified wages of up to three qualified employees, not to exceed $5,000 per qualified employee.

This bill would define the following terms:

- Microbusiness would mean a business with 10 or fewer employees.
- Qualified employee would mean a full or part-time employee that is between 18 and 25 years of age and has not previously received wages subject to wage withholding in California or any other state from any employer.
- Qualified taxpayer would mean a microbusiness that pays or incurs qualified wages.
- Qualified wages would mean wages paid or incurred by the qualified taxpayer during the taxable year to qualified employees.
- Wages would mean wages subject to withholding under Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.

Credit amounts in excess of the tax due would be allowed to be carried forward until exhausted.

The tax credit provisions would remain in effect until December 1, 2026, and would be repealed as of that date.

In un-codified law, meaning language that lacking a code section reference, this bill would, for purposes of complying with Section 41 of the Revenue and Taxation Code (R&TC):

- Define the goal, purpose, or objective of the tax credit as the expansion of employment opportunities for individuals entering the workforce for the first time and alleviate the cost burden on microbusinesses in training individuals entering the workforce for the first time by creating hiring incentives for those individuals.
- Specify that the performance indicator measuring whether the tax credit meets the goal, purpose, or objective is the number of taxpayers that are allowed the tax credit.
- Require the Franchise Tax Board (FTB) to annually publish anonymized data on the tax credit through calendar year 2026, notwithstanding the general prohibition on disclosure under R&TC section 19542.

Effective/Operative Date

As a tax levy, this bill would be effective upon enactment and specifically operative for taxable years beginning on or after January 1, 2021, and before January 1, 2026.

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.

Under federal law, the Work Opportunity Tax Credit is allowed to employers that hire qualified individuals from certain target groups who have consistently faced significant barriers to employment, including individuals with disabilities and veterans. The maximum tax credit generally ranges from $1,200 to $9,600, depending on the employee hired and the length of employment.

Under current state law, the New Employment Credit (NEC) 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 or Local Agency Military Base Recovery Area. The qualified taxpayer must receive a tentative credit reservation from the 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.

State law also allows the Prison Inmate Labor Credit in an amount equal to 10 percent of the wages paid or incurred during the taxable year to a prisoner who is certified by the Department of Corrections as an active participant in a joint venture program, as specified. As of February 14, 2020, there were six active joint ventures reported on the California Prison Industry website.

Qualified wages are also a component in determining the state’s motion picture and television production credits.

R&TC section 41 requires legislation that would create a new tax expenditure, including a credit, deduction, exclusion, exemption, or any other tax benefit to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax expenditure.

Implementation ConsiderdAHLE)ations

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.

An individual between 18 and 25 years old that had previously received wages for work outside of the United States would meet the definition of qualified employee for the purpose of this credit. If this is contrary to the author’s intent this bill should be amended.

Because an individual that received wages in a prior year would be excluded from the definition of qualified employee, wages paid to the same individual during subsequent taxable years would be ineligible for the credit. If this is contrary to the author’s intent this bill should be amended.

It is unclear whether the $5,000 per qualified employee limit applies to the credit or to the wages eligible for the credit. In other words, would the maximum credit for three employees be $15,000 or 30 percent of $15,000? For clarity and to avoid disputes between taxpayers and the department, this bill should be amended.

It is unclear when or how often the determination would be made as to whether the definition of microbusiness and qualified employee applies. For example, would these determinations be made as of an individual's first date of employment with the qualified employee? Would an otherwise qualified taxpayer that exceeded 10 employees during the taxable year be ineligible for the credit or would qualified wages paid or incurred prior to the date the employment limit was exceeded remain eligible for the credit? For clarity and to insure consistency with the author's intent, this bill should be amended.

The bill is silent on how a qualified employer would verify that an employee had no history of receiving wages, as specified. Lack of verification could lead to the disallowance of a claimed credit and the imposition of interest and penalties if the employee is later found to have been previously employed. To avoid this situation, the author may wish to amend the bill to require the employee provide an IRS Wage and Income Transcript or Verification of Non-Filing Letter, or social security wage history statement to the qualified employer.

The bill's uncodified requirement that the FTB annually publish anonymized data is unclear. For example, the phrase "anonymized data on the credits" is undefined and the bill is silent on when publishing would initially be due. It should also be noted that complete information for a taxable year would be unavailable for approximately 18 months in order to include data from returns filed by the extended due date, meaning that complete information for 2021, the initial year of the credit, would be unavailable until approximately mid-year 2023.

Technical Considerations

None noted.

Policy Concerns

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits (i.e. credits or deductions) for the same wages paid.

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

LEGISLATIVE HISTORY

AB 1726 (Cervantes, 2019/2020) would have among other things, created in modified conformity with the Federal Work Opportunity Tax Credit, a California Work Opportunity Tax Credit for qualified employers. AB 1726 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

SB 422 (Hueso, 2019/2020) would among other things, create an income tax credit for a qualified taxpayer that hires a qualified full-time employee and receives a tentative credit reservation for that qualified full-time employee. Similar to this bill SB 422 would require a qualified full-time employee to be between 18 and 25 years of age, in addition to meeting other requirements. SB 422 is pending before the Assembly Revenue and Taxation Committee.

AB 916 (Quirk-Silva & Arambula, 2017/2018) would have among other things, created in modified conformity with the Federal Work Opportunity Tax Credit, a California Work Opportunity Tax Credit for qualified employers. AB 916 failed to pass out of the Senate Committee on Appropriations by the constitutional deadline.

AB 1586 (Gallagher, 2017/2018) would have created an income tax credit for qualified wages paid by a taxpayer to employees who have little to no functional hearing. AB 1586 failed to pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 2945 (Gallagher, 2017/2018) would have created an income tax credit for qualified wages paid or incurred by a qualified employer to employees that have little to no functional hearing and who have completed, or is completing, rehabilitative services, as specified. AB 2945 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

AB 3029 (Arambula, 2017/2018) would have among other things, modified the NEC's sunset date and added a new NEC with broader definitions of qualified taxpayer and qualified full-time employee and no geographic restriction on where the work subject to the new NEC must occur. AB 3029 failed to pass by the constitutional deadline.

SB 661 (Fuller, 2017/2018) would have among other things, repealed and recast the NEC to expand eligibility by redefining qualified full-time employee and qualified taxpayer. SB 661 failed to pass by the constitutional deadline.

SB 90 (Galgiani and Canella, Chapter 70, Statutes of 2013), among other things, modified the NEC by revising the definition of qualified employee, excluding sexually oriented businesses from the definition of qualified taxpayer and small business, and revising the geographical area where the work subject to the NEC must occur.

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

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process and implementation considerations are resolved, costs will be identified.

ECONOMIC IMPACT

The bill states that for purposes of Section 41, the goal, purpose, or objective this credit is to expand employment opportunities for individuals entering the workforce and alleviate the cost burden on microbusinesses in training individuals entering the workforce for the first time by creating hiring incentives for those individuals. The Legislature's evaluation of the credit's success would be based on the number of taxpayers taking the credit.

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2041 as Introduced February 3, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	-$4.1
2021-2022	-$10
2022-2023	-$13

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 Bureau of Labor Statistics (BLS) and the California Employment Development Department, it is estimated that approximately 15,000 first-time employees would be hired by microbusinesses and would be between the ages of 18 to 25 years old in 2021. This bill specifies that no more than three employees per taxpayer can be used in the calculation of the credit. To account for this limitation, it is assumed that 60 percent, or 9,000 first-time employees would generate the credit.

To estimate the amount of qualified wages earned, various assumptions were made regarding wages paid and hours worked.

Applying the 30 percent credit rate and the $5,000 per employee credit limitation, up to a maximum $15,000 per employer, results in an estimated $45 million in credit generated in taxable year 2021. It is estimated that 70 percent, including the S Corporation adjustment, or $32 million would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount 25 percent, or $7.5 million, would be claimed in the year generated and the remaining credit would be used in the subsequent years.

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE STAFF CONTACT

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