



Bill Analysis

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Bill Number: AB 2041

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Amended: March 9, 2020

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Related Bills: See Legislative
History

SUBJECT

Hiring credit qualified full-time employee former foster youth or ex-offender

SUMMARY

This bill would, under the Personal Income Tax law (PITL) and the Corporation Tax Law (CTL), allow a credit to a qualified employer for wages paid to certain qualified full-time employees.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

The March 9, 2020, amendments removed provisions that would have under the PITL and CTL, allowed a credit for qualified wages paid to a qualified employee by a qualified taxpayer that is a microbusiness and replaced them with the provisions discussed in this analysis.

REASON FOR THE BILL

The reason for the bill is to encourage qualified employers to hire former foster youth and ex-offenders between 18 and 25 years old.

ANALYSIS

This bill would, under the PITL and the CTL, for taxable years beginning on or after January 1, 2021, and before January 1, 2023, allow a credit to a qualified taxpayer that hires a qualified full-time employee, pays or incurs wages attributable to work performed by the qualified full-time employee, and receives a tentative credit reservation from the Franchise Tax Board (FTB) for that qualified full-time employee. The credit would be zero absent an appropriation in a bill providing for appropriations related to the Budget Act for taxable years beginning on or after January 1, 2021, and before January 1, 2023.

Subject to receipt of a tentative credit reservation and appropriation as specified, the amount of the credit for a taxable year would be equal to 50 percent of all wages paid or incurred to the qualified full-time employee, not to exceed \$15,000 per qualified taxpayer per taxable year. The credit must be claimed on a timely filed original return.

For purposes of this credit, qualified taxpayer would mean a person or entity engaged in a trade or business within the state that during the taxable year pays or incurs wages to a qualified employee. For a pass-thru entity, defined as a partnership or S-Corporation, the determination of whether a taxpayer is a qualified taxpayer would be made at the entity level and any credit would pass-thru to the entity's partners and shareholders in accordance with the applicable provisions of the PITL or CTL. Qualified taxpayer would specifically exclude employers that provide temporary help services, retail trade services, are primarily engaged in providing food services, or that is a casino, casino hotel, place serving alcoholic drinks, or a sexually oriented business, as defined.

This bill would define the following terms and phrases:

- "Acquire" would include any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.
- "Job training provider" would mean an entity that delivers a combined job readiness and life-skills training program that, at a minimum, includes high school or continuing education courses. The entity's program may also offer additional services like job placement, career and mental health counseling, prisoner reentry services, and relapse prevention and sober-living support.
- "Minimum wage" would mean the wage as defined in the Labor Code.
- "Qualified full-time employee" would mean an individual who is, at the time of hiring, between 18 and 25 years of age, and is both hired by the qualified taxpayer on or after January 1, 2021, and is either a former foster youth or an ex-offender previously convicted of a felony. An individual would be a qualified full-time employee only for the 60 month period of time beginning with the date the individual is first employed by the qualified taxpayer. The Legislature strongly encourages qualified taxpayers to hire individuals who are former juvenile offenders.
- Seasonal employment would mean employment by a qualified taxpayer that has regular and predictable substantial reductions in trade or business operations.

For purposes of this credit, the FTB would be required to do all of the following:

- Approve a tentative credit reservation with respect to a qualified full-time employee hired during a calendar year.
- Determine the aggregate tentative reservation amount.

- Provide a searchable database on its internet website, for each taxable year beginning on or after January 1, 2021, and before January 1, 2023, containing the employer names, amounts of tax credit claimed, and number of new jobs created for each taxable year. The database's information would not be subject to the general confidentiality provisions of Revenue and Taxation Code (R&TC) section 19542.

All employees of trades or businesses that are unincorporated and under common control would be treated as employed by a single taxpayer.

The credit allowable with respect to each trade or business would be determined by reference to its proportionate share of the expense of the qualified wages giving rise to the credit and would be allocated to that trade or business in that manner.

Principles that apply in the case of controlled groups of corporations would apply with respect to determining employment.

If an employer acquires the major portion of a trade or business or the major portion of a separate unit of a trade or business of another employer the employment relationship between a qualified full-time employee and an employer would not be treated as terminated for any taxable year ending after that acquisition if the employee continues to be employed in that trade or business.

If the qualified full-time employee is terminated by the qualified taxpayer during the first 36 months after commencing employment, whether or not consecutive, the tax imposed on the qualified taxpayer for that taxable year would be increased by the amount of credit previously allowed, with the following exceptions:

- The qualified full-time employee voluntarily leaves the employment of the qualified taxpayer.
- The qualified full-time employee becomes disabled and unable to perform the services of employment, unless that disability is removed before the close of that period and the qualified taxpayer fails to offer reemployment to that employee.
- The qualified full-time employee was terminated for misconduct, as specified.
- The termination was due to a substantial reduction in the trade or business operations of the qualified taxpayer, including reductions due to seasonal employment.
- The terminated qualified full-time employee is replaced by other qualified full-time employees so as to create a net increase in both the number of employees and the hours of employment.

A change in the qualified taxpayer's form of conducting the trade or business would not terminate the employment relationship between the qualified taxpayer and a qualified full-time employee if the qualified full-time employee continues to be employed in that trade or business and the qualified taxpayer retains a substantial interest in that trade or business.

An increase in tax due for the taxable year resulting from the termination of a qualified full-time employee within the first 36 months of employment could not be reduced by the credit otherwise allowable for that taxable year.

Credits in excess of the tax liability may be carried over for up to 5 years.

The credit would be allowed in lieu of any deduction or other credit based on the same qualified wages.

The FTB may prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of this section, including any guidelines regarding the allocation of the credit allowed under this section. The requirements under the Administrative Procedures Act would be inapplicable to any rules, guidelines, or procedures prescribed by the FTB.

The credit provisions would remain in effect until December 1, 2023, and be repealed as of that date.

Section 3 of this bill contains language that would not be included in the numbered sections of the R&TC and for purposes of complying with Section 41 of the R&TC would:

- Specify the goal, purpose, and objective of the credits is to provide an economic incentive for qualified employers to hire members of a historically disadvantaged demographic group to help those individuals overcome barriers to employment and promote their successful transition into society.
- Specify that the effectiveness of the credits would be measured by the number of qualified employees who are hired as a result of the credit and the number of employers that claim the credit.
- Require the FTB to annually report to the Joint Legislative Budget Committee, by no later than March 1, the total dollar amount of the credits claimed for the relevant fiscal year. The report must include a comparison of the total dollar amount of the credits claimed for the fiscal year with the Employment Redevelopment Department's estimate for the same fiscal year. If the total dollar amount of credits claimed for the fiscal year is less than the estimate the report must identify options for increasing annual claims of the credit to meet the estimated amounts.

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, 2021, and before January 1, 2023.

Federal/State Law

Federal Law

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. There is no limit on the number of individuals an employer can hire to qualify to claim the WOTC.

The amount of the WOTC employers may claim with respect to each individual 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.

An employer must receive certification from the Internal Revenue Service that an individual is a member of a targeted group before the credit may be claimed.

State Law

For taxable years beginning on or after January 1, 2014, and before January 1, 2021, current state law allows a 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 or former Enterprise Zone. 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.

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.

It is unclear whether the \$15,000 limitation on the credit would apply to the wages paid to the qualified full-time employee or the amount of credit allowed. To avoid disputes between taxpayers and the department, this bill should be amended.

This bill uses the undefined term “former foster youth.” The absence of a definition could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define the term. For example, by reference to provisions of the Welfare and Institutions Code related to delinquents and wards of the Juvenile Court.

The defined term “qualified full-time employee” is silent on the definition of full-time. To avoid disputes between taxpayers and the department it is recommended the bill be amended to define full-time for both hourly and salaried employees.

The bill’s uncodified requirement that the FTB submit an annual report to the Joint Legislative Budget Committee is unclear. For example, the phrase “relevant fiscal year” is undefined and the bill is silent on when publishing would initially be due. It should also be noted that the report would be due during the peak of the tax return filing season which could impact the availability of data and complete information for a taxable year would be unavailable for approximately 18 months after the April 15th due date 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. The bill should be amended to ensure the reporting requirement is consistent with the author’s intent.

To avoid delayed implementation, it is recommended that the bill be amended to grant the FTB regulatory authority and a waiver from rulemaking procedures required under the Administrative Procedures Act by replacing the phrase “rules, guidelines, or procedures” with “regulations.”

Technical Considerations

For consistent use of terminology and internal harmony within the code the word “like” used in paragraph 2 of subdivision (b) of Sections 1 and 2 of this bill should be replaced with the phrase “including but not limited to.”

The definition of “qualified full-time employee” uses the phrase, “is either of the following.” Because an individual could be both a former foster youth and an ex-offender previously convicted of a felony, it is suggested that the phrase be amended to read “is either or both of the following.”

The unused defined terms, “job training provider” and “minimum wage” are unnecessary and can be deleted.

Policy Concerns

The credit would be allowed for wages paid or incurred either inside or outside California.

LEGISLATIVE HISTORY

SB 422 (Hueso, 2019/2020) would allow qualified employers an income tax credit based on wages paid to certain full-time employees who among other things are an ex-offender previously convicted of a felony and are between the age of 18 and 25 years of age on the date hired by the qualified employer. SB 422 is currently on the Assembly Appropriation Committee's suspense file.

AB 3029 (Arambula, 2017/2018) would have created a California NEC that would have allowed a credit to qualified full-time employees who were ex-offenders. 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.

SB 1216 (Hueso, 2015/2016) would have allowed a credit to a qualified employer who employed a qualified employee who was an ex-felon. SB 1216 failed to pass by the constitutional deadline.

SB 90 (Galgiani and Canella, Chapter 70, Statutes of 2013) modified AB 93 as chaptered on July 11, 2013. Specifically, SB 90, for purposes of the NEC, modified the definition of qualified employee, excluded sexually oriented businesses from the definition of qualified taxpayer and small business, and modified the defined geographical area that the hiring credit may be generated in.

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. However, implementing this bill would require the department to develop, program, and test revisions to existing systems and create a credit reservation system, which could be costly. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

The bill states that for purposes of Section 41, the goal, purpose, or objective of this credit is to provide an economic incentive for qualified employers to hire members of a historically disadvantaged demographic group that faces tremendous barriers to employment.

The FTB would be required to annually report to the Joint Legislative Budget Committee the total dollar amount of the credits claimed under Sections 17053.75 and 23675 of the R&TC with respect to the relevant fiscal year, as well as the growth or decline of credits claimed under these sections each successive fiscal year from January 1, 2021, to January 1, 2023, inclusive, so that the Legislature can monitor the overall progress of the credit. The report must be submitted in compliance with Section 9795 of the Government Code.

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2041 as Amended March 9, 2020
Assumed Enactment after June 30, 2020

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$0.5
2021-2022	-\$2.4
2022-2023	-\$4.0

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 industry and government data, it is estimated that California would have approximately 31,000 ex-offenders previously convicted of a felony and approximately 19,000 former foster youth between the ages of 18 and 25 in taxable year 2021. Based on employment statistics from the Employee Development Department and other relevant literature, it is assumed that 5 percent of ex-felons and former foster youth would find full time jobs in the qualifying businesses because of the incentive effect of this bill. This would result in the employment of an estimated 2,500 qualified full-time employees.

Based upon the initial experience with the NEC, the FTB estimates 50 percent of qualified employers would receive tentative credit reservations in the first year, increasing to 75 percent in the second year. Because the employer must receive a tentative credit reservation to be eligible for the credit, an estimated 1,300 employees, where half are hired in the first half of the year and half are hired in the second half of the year, would qualify for the credit and would receive qualifying wages of \$19 million. Applying the 50 percent credit rate results in approximately \$9.5 million in credit generated. The credit is reduced further to account for the qualified employees leaving their jobs, taxpayers claiming other credits related to these qualified wages, and the \$15,000 total cap per qualified employer. This results in an estimated \$4.8 million of credit generated in the 2021 taxable year.

It is assumed that 60 percent of the credit would be claimed by corporate taxpayers and the remainder by personal income taxpayers. It is estimated that 80 percent, including the S corporation adjustment, or \$3.8 million, would be earned by taxpayers who have tax liability to offset with the credit. Of that amount, it is estimated that 55 percent, or \$2.1 million, would be claimed in the year generated and the remaining would be claimed in subsequent years.

To arrive at the offsetting tax effect of expense deductions that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be unable to deduct approximately \$16 million in qualified wages in taxable year 2021. Applying an average tax rate of 6 percent, results in an offsetting revenue gain of \$960,000. The resulting net revenue loss, for taxable year 2021, would be \$1.1 million.

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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