



Summary Analysis of Amended Bill

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Sponsor:

Bill Number: SB 422

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Related Bills: See Prior Analysis

Subject: Hiring Credit

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 full-time employees.

Recommendation – No position.

Summary of Amendments

The July 1, 2019, amendments added reporting requirements in off-code language. As a result of these amendments, the “This Bill” section provided in the department’s analysis of the bill as amended May 17, 2019, has been revised and an additional “Implementation Consideration” has been identified. Except for those sections and the updated “Fiscal Impact” section, the remainder of analysis of the bill as amended May 17, 2019, still applies. The remaining “Implementation Considerations,” “Technical Considerations,” “Economic Impact,” and “Policy Concerns” sections have been restated for convenience.

This Bill

This bill would, under the PITL and the CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2022, allow a credit to a qualified taxpayer that hires a qualified full-time employee and receives a tentative credit reservation 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, 2020, and before January 1, 2022.

The amount of the credit for a taxable year would be equal to 50 percent of all qualified wages paid or incurred to the qualified full-time employee, not to exceed \$15,000 per qualified taxpayer per taxable year.

A “qualified taxpayer” would mean a person or entity engaged in a trade or business with the state that during the taxable year pays or incurs qualified wages. For a pass-thru entity, 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 partners and shareholders in accordance with the applicable provisions of the PITL or CTL.

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 corporations¹ shall apply with respect to determining employment.

“Qualified taxpayer shall not include any of the following:

- Employers that provide temporary help services, as described in Code 561320 of the North American Industry Classification published by the United States Office of Management and Budget, 2012 edition, hereinafter “NAICS”.
- Employers that provide retail services, as described in Sector 44-45 of the NAICS.
- Employers that are primarily engaged in providing food services, as described in Code 711110, 722511, 722513, 722514, or 722515.
- Employers that are primarily engaged in services described in Code 713210, 721120, or 722410 of the NAICS.
- An employer that is a sexually oriented business.
 - “Sexually oriented business” means a nightclub, bar, restaurant, or similar commercial enterprise that provides for an audience of two or more individuals live nude entertainment or live nude performances where the nudity is a function of everyday business operations and where nudity is planned and intentional part of the entertainment or performance.
- “Pass-thru entity” means any partnership or “S” corporation.
- In the case of an estate or trust, both of the following apply:
 - The qualified wages for a taxable year shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each.
 - A beneficiary to whom any qualified wages have been apportioned, shall be treated as the employer.

¹ As specified in subdivision (f) of Section 23675.

All employees of the trades or businesses that are treated as related² would be treated as employed by a single taxpayer.

To be eligible for a credit, a qualified taxpayer would be required, upon hiring a qualified full-time employee, to request a tentative credit reservation from the Franchise Tax Board (FTB) within 30 days of complying with the Employment Development Department's (EDD) new hire reporting requirements³, in the form and manner prescribed by the FTB.

A tentative credit reservation provided to a qualified taxpayer with respect to a qualified full-time employee of that qualified taxpayer would not constitute a determination by the FTB with respect to any of the requirements regarding a qualified taxpayer's eligibility for the credit this bill would allow.

To obtain a tentative credit reservation with respect to a qualified full-time employee, the qualified taxpayer would be required to provide necessary information, as determined by the FTB, including:

- Name
- Social security number
- Start date of employment
- Rate of pay

The qualified taxpayer would be required to provide the FTB an annual certification of employment with respect to each qualified full-time employee hired in a previous taxable year, on or before the 15th day of the third month of the taxable year. The certification shall include the necessary information for each qualified full-time employee employed by the qualified taxpayer, as determined by the FTB including:

- Name
- Social security number
- Start date of employment
- Rate of pay

"Qualified full-time employee" would mean an individual who meets all of the following conditions:

- Receives starting wages that are at least 125 percent of minimum wage.
- Is hired by the qualified taxpayer on or after January 1, 2020.

² Under Section 267, 318, or 707.

³ As provided in Section 1088.5 of the Unemployment Insurance Code.

- Satisfies either of the following conditions:
 - Is paid qualified wages by the qualified taxpayer for services not less than an average of 35 hours per week, or
 - Is a salaried employee and was paid compensation during the taxable year for full-time employment⁴ by the qualified taxpayer.
- Is an ex-offender previously convicted of a felony who is at the time of hiring, between the age of 18 and 25 years of age, and who demonstrated documented completion of any of the following:
 - A work readiness program;
 - A substance abuse treatment program;
 - A cognitive behavioral therapy treatment program; or
 - An anger management program.

“Minimum wage” would mean the wage established pursuant to Chapter 1 (commencing with Section 1171) of Part 4, of Division 2 of the Labor Code.

“Work readiness program” would mean a program offered by a job training provider that provides vocational job training, educational opportunities, and life skills. A work readiness program must focus on skills acquisition and educational advancement and must foster behavioral changes that promote personal responsibility and positive contributions to society. A work readiness program shall include all of the following:

- Paid or unpaid on-the-job training opportunities, pre-apprenticeship programs, vocational instruction, or internship placement.
- The opportunity for academic advancement.
- The opportunity to earn at least one industry recognized certification.
- A life-skills training component.

“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.

⁴ Within the meaning of Section 515 of the Labor code.

“Qualified wages” would mean wages that meet all of the following requirements:

- That portion of wages paid or incurred by the qualified taxpayer during the taxable year to each qualified full-time employee that exceeds 125 percent, but does not exceed 350 percent of minimum wage.
- Wages paid or incurred during the 60-month period beginning with the first day the qualified full-time employee commences employment with the qualified taxpayer.
 - In the case of any employee who is reemployed, including a regularly occurring seasonal increase, in the trade or business operations of the qualified taxpayer, this reemployment shall not be treated as constituting commencement of employment.
 - “Seasonal employment” means employment by a qualified taxpayer that has regular and predictable substantial reductions in trade or business operations.

If the qualified full-time employee is terminated by the qualified taxpayer at any time 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, unless any of the following occur:

- 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.⁵
- The qualified full-time employee was terminated for misconduct.⁶
- 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.
- The termination of employment of the qualified full-time employee, when that employment is considered seasonal employment and the qualified full-time employee is rehired on a seasonal basis.

⁵ Unless the qualified taxpayer fails to offer reemployment of that employee if the disability is removed.

⁶ As defined in Sections 1256-30 to 1256-43 of Title 22 of the California Code of Regulations.

The employment relationship between the qualified taxpayer and a qualified full-time employee would not be treated as terminated by reason of a mere change in the form of conducting the trade or business of the qualified taxpayer 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.

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, 2020, and before January 1, 2022, containing the employer names, amounts of tax credit claimed, and number of new jobs created for each taxable year.

This credit may be carried over to reduce the net tax for up to 5 years, until exhausted. This credit may only be claimed on a timely filed original return of the qualified taxpayer and only with respect to a qualified full-time employee for whom the qualified taxpayer received a tentative credit reservation.

This credit would be allowed in lieu of any deduction or other credit that was generated in whole or in part 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. Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code (GC) shall not apply to any rule, guideline, or procedure prescribed by the FTB pursuant to this section.

The FTB would be required to provide annually to the Joint Legislative Budget Committee,⁷ by no later than March 1, a report of the total dollar amount of the credits claimed for the relevant fiscal year. The report must compare the total dollar amount of credits claimed for the fiscal year with the department's estimate with respect to that same fiscal year. If the total dollar amount of credits claimed for the fiscal year is less than the estimate for that fiscal year, the report must identify options for increasing annual claims of the credit so as to meet estimated amounts.

The bill states that Section 41 shall not apply to this bill.

⁷ In compliance with Section 9795 of the GC.

This section would remain in effect until December 1, 2022, and be repealed as of that date.

In off-code language, the bill states that for purposes of complying with Section 41 that the FTB shall annually report to the Joint Legislative Budget Committee the total dollar amounts of the credits claimed with respect to the relevant fiscal year, as well as the growth or decline of credits claimed for each successive fiscal year from January 1, 2020, to January 1, 2022.

Implementation Considerations

The department has identified the following implementation considerations. 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 qualified full-time employees or to the amount of credit allowed. To avoid disputes between taxpayers and the department, this bill should be amended.

This bill uses terms and phrases that are undefined, i.e., "major portion of a trade or business," "substance abuse treatment program," "cognitive behavioral therapy treatment program," and "anger management program." The absence of definitions to clarify this phrase 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 these terms and phrases.

The bill states that the Section 41 requirements shall not apply. However, the amendments add off-code language that appears to address the provisions of Section 41. If it is the author's intent that the off-code language should address the provisions of Section 41, the bill should be amended to remove subdivision (l).

The bill is silent as to who, when, how often, and by whom the number of employees hired as a result of the credit and the number of employers who claim the credit would be provided. To ensure consistency with the author's intent, this bill should be amended.

Technical Considerations

For consistent use of terminology and internal harmony within the code the word "like" on page 3, line 1, and page 9, line 40, should be replaced with the phrase "including but not limited to."

Fiscal Impact

Staff estimates a first-year cost of approximately \$2 million in fiscal year 2020-2021, and ongoing costs of approximately \$143,000 to develop, program, and test revisions to existing systems and update a credit reservation system for this bill.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 422 as Amended July 1, 2019
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$0.7
2020-2021	-\$3.4
2021-2022	-\$3.6

This estimate assumes that specific appropriation of funds are made beginning in fiscal years 2019-2020 through 2021-2022.

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 there would be approximately 30,000 ex-offenders previously convicted of a felony in California between the ages of 18 and 25 in taxable year 2020. Based on employment statistics from the EDD and ex-felon employment research studies on re-entry programs, it is estimated that approximately 6 percent, or 1,900, of these individuals would complete either a qualified work readiness program, a substance abuse treatment program, a cognitive behavioral therapy treatment program, or an anger management program. It is also estimated that these individuals would find employment with a qualified business, and have qualified wages as specified in the bill, in the 2020 taxable year.

Based upon the initial experience with the New Employment Credit, 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 950 employees hired would qualify for the credit and would receive qualifying wages of \$11 million. Applying the 50 percent credit rate results in credits of \$5.5 million. The credit is reduced by 15 percent to account for taxpayers claiming other credits related to these qualified wages. This results in \$4.6 million of credit generated in the 2020 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 85 percent, including the S corporation adjustment, or \$3.9 million, would be earned by taxpayers who have tax liability to offset with the credit. Of that amount, it is estimated that 50 percent, or \$1.9 million, would be claimed in the year generated and the remaining 50 percent would be claimed in the subsequent years.

To arrive at the offsetting tax effect of the expense deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be unable to deduct approximately \$2.5 million in qualified expenses in taxable year 2020. Applying an average tax rate of 8 percent, results in an offsetting revenue gain of \$200,000. The resulting net revenue loss, for taxable year 2020, would be \$1.6 million. The tax year estimates are converted to fiscal year, and rounded to arrive at the amounts reflected in the above table.

Policy Concerns

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

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