



Bill Analysis

Author: Committee on
Budget

Sponsor:

Bill Number: AB 194

Related Bills: See Legislative History
Amended: June 25, 2022

SUBJECT

Taxation Budget Trailer Bill

SUMMARY

This bill would do the following:

Provision No. 1 – Credit Offsets:

Section 1 of the bill, under the Government Code (GC), would specify that the California State Controller (Controller) cannot offset delinquent accounts against personal income tax (PIT) refunds of an individual who receives a California Earned Income Tax Credit (CalEITC) or a Young Child Tax Credit (YCTC) for taxable years beginning on or after January 1, 2024.

Provision No. 2 – Main Street Small Business Credits I and II:

Sections 4, 5, 11, 12, and 18 of the bill, under the Personal Income Tax Law (PITL) and the Corporation Tax law (CTL), would remove the requirement that a Small Business Hiring Credit (SBHC) (commonly known as the Main Street Small Business Credits I and II) be claimed on a timely filed original return. Instead, a qualified small business employer that received a tentative credit reservation would be allowed to claim the SBHC on an amended return.

Provision No. 3 – Homeless Hiring Tax Credit:

Sections 6 and 13 of the bill, under the PITL and CTL, would make several changes to the Homeless Hiring Tax Credit (HHTC) by modifying the definition of an eligible individual, allowing for eligible individuals to receive a new certification, removing the provision that required the credit be claimed on a timely filed return, and modifying the credit reservation requirements.

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Provision No. 4 – California Competes Tax Credit Extension:

Sections 7 and 14 of the bill, under the PITL and CTL, would extend the California Competes Tax Credit (CCTC) allocations through the 2027-2028 fiscal year, add additional factors for Governor's Office of Business and Economic Development (GO-Biz) to consider when allocating the CCTC, and would make other nonsubstantive changes.

Provision No. 5 - Paycheck Protection Program Extension Act of 2021:

Sections 8, 15, 16, and 19 of the bill, under the PITL and the CTL, would expand the exclusion from gross income for covered loan amounts, for loans forgiven pursuant to the Paycheck Protection Program (PPP) Extension Act (PPPEA) of 2021.

Provision No. 6 - Repealed Penalty and One-Time Penalty Abatement:

Sections 9 and 10 of the bill, under the Revenue and Taxation Code (RTC), would repeal an obsolete penalty waiver provision applicable to victims of the 1994 Northridge earthquake; and would establish penalty abatement authority similar to the federal first-time abatement procedure, except that it would apply to individuals subject to the PITL only and would be a one-time abatement.

RECOMMENDATION

No position on Provisions No. 1 – No. 5.

Provision No. 6 of the bill is supported by the three-member Franchise Tax Board (Board). On December 10, 2018, the Board voted in favor of sponsoring this language.

SUMMARY OF AMENDMENTS

The June 25, 2022, amendments removed intent language relating to the Budget Act of 2022, and replaced it with the provisions discussed in this analysis.

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

REASON FOR THE BILL

The reason for Provisions No. 1 – No. 5 is to make various statutory changes related to implementing the Budget Act of 2022.

The reason for Provision No. 6 is to authorize the Franchise Tax Board (FTB) to grant penalty relief that is similar to the Internal Revenue Service (IRS) practice of granting administrative relief to compliant taxpayers that could reduce taxpayer dissatisfaction and result in increased filing compliance.

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Economic Impact – Summary Revenue Table (\$ in Millions)

Fiscal Year	2020-2021	2021-2022	2022-2023	2023-2024
Provision No. 1 – Credit Offsets	N/A	N/A	N/A	N/A
Provision No. 2 - SBHC	-\$2.5	-\$6.1	-\$6.8	-\$4.6
Provision No. 3 – HHTC	N/A	N/A	N/A	N/A
Provision No. 4 – CCTC	N/A	*	*	*
Provision No. 5 – PPPEA of 2021	N/A	-\$160	-\$160	-\$65
Provision No. 6 – Repealed Penalty and One-Time Penalty Abatement	N/A	-\$2.2	-\$8.9	-\$7.5

*For revenue figures, refer to Department of Finance (DOF).

ANALYSIS***Analysis Provision No. 1: Credit Offsets (Section 1)***

This provision of the bill would, under the GC, for taxable years beginning on or after January 1, 2024, specify that the Controller cannot offset delinquent accounts against PIT refunds of an individual who receives a CalEITC or a YCTC for the taxable year. This provision would not apply to delinquent accounts for the nonpayment of child or family support.

Effective/Operative Date

As a provision within a bill providing for appropriations relating to the Budget Bill, this provision would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2024.

*Federal/State Law**Offsets*

Under federal law, the Treasury Offset Program offsets federal tax refunds for delinquent non-tax debts owed to federal agencies, to child support authorities, and tax debts owed to state taxing agencies.

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Under state law, the Controller is authorized to offset delinquent accounts against PIT refunds that have been certified by the FTB. Income tax refunds are available for offset only after all existing income tax debts have been satisfied.

CalEITC and YCTC Programs

Existing federal law allows eligible individuals a refundable Earned Income Tax Credit (EITC). A refundable credit allows for the excess of the credit over the taxpayer's tax liability to be refunded to the taxpayer. The federal EITC is a percentage of the taxpayer's earned income and is phased out as income increases.

State law provides a refundable CalEITC that is generally determined in accordance with the Internal Revenue Code (IRC) section 32, as applicable for federal income tax purposes for the taxable year, except as modified. For 2021, the CalEITC is generally available to eligible individuals with earned income of \$30,000 or less.

Starting in 2019, a taxpayer who has been allowed the CalEITC and who has a qualifying child younger than six years of age as of the last day of the taxable year may qualify for the YCTC. In addition, for taxable years beginning on or after January 1, 2022, an individual that would otherwise be eligible for the CalEITC, but does not have earned income, would be eligible for the YCTC.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 1424 (Perea, Chapter 455, Statutes of 2011), under the GC, amongst other things, allowed the FTB to offset tax refunds with delinquent tax debts owed to the IRS or other states, but only upon a reciprocal agreement in which the IRS or other state's tax refunds are offset for delinquent tax debts owed to California.

PROGRAM BACKGROUND

None noted.

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FISCAL IMPACT

Provision No. 1 would impact the department's systems, resulting in programming and processing costs. Staff estimates the cost to implement this provision to be approximately \$982,000 in fiscal year 2023-2024 and \$475,000 in fiscal year 2024-2025.

ECONOMIC IMPACT

Revenue Estimate

Provision No. 1 of the bill as amended on June 25, 2022, would not change the manner in which the income or franchise tax is calculated under the RTC.

LEGAL IMPACT

None noted.

Analysis Provision No. 2: Main Street Small Business Credits (Sections 4, 5, 11, 12, and 18)

Sections 4 and 12: Main Street Small Business Credit II (Main Street II)

Under the PITL and the CTL, for taxable years beginning on or after January 1, 2021, and before January 1, 2022, this provision of the bill would remove the requirement that a qualified small business employer claim a SBHC on a timely filed original return. The qualified small business employer that received a tentative credit reservation would be allowed to claim the credit on an amended tax return for taxable years beginning on or after January 1, 2021, and before January 1, 2022.

This provision would extend the sunset date from December 1, 2022, until December 1, 2026.

Sections 5 and 11: Main Street Small Business Credit I (Main Street I)

Under the PITL and the CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2021, this provision of the bill would remove the requirement that a qualified small business employer claim a SBHC on timely filed original return. The qualified small business employer that received a tentative credit reservation would be allowed to claim the credit on an amended tax return for taxable years beginning on or after January 1, 2020, and before January 1, 2021. This provision also states the Legislature's intent to allow this credit to be claimed on an amended return.

This provision would remain in effect until December 1, 2025, and would be repealed as of that date.

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Effective/Operative Date

As a provision within a bill providing for appropriations related to the Budget Bill, this provision would be effective immediately, and operative for taxable years beginning on or after January 1, 2020, and before January 1, 2021, with respect to the changes to Main Street I, and for taxable years beginning on or after January 1, 2021, and before January 1, 2022, with respect to the changes to Main Street II.

Federal/State Law

Federal Law

No comparable provision in federal law.

State Law

Main Street I and II

Main Street I: for each taxable year beginning on or after January 1, 2020, and before January 1, 2021, under the PITL and CTL, state law allowed a SBHC to a qualified small business employer that received a tentative credit reservation. The credit was equal to \$1,000 for each net increase in qualified employees, as specified, and was limited to \$100,000 for any qualified small business employer.

Main Street II: for each taxable year beginning on or after January 1, 2021, and before January 1, 2022, under the PITL and CTL, state law allowed a SBHC to a qualified small business employer that received a tentative credit reservation. The credit was equal to \$1,000 for each net increase in qualified employees, as specified, not to exceed \$150,000 for any qualified small business employer. For qualified small business employers that received a tentative credit reservation under Main Street I, the tentative credit reservation amount was reduced by:

- If a qualified small business employer applied the credit against qualified sales and use taxes (SUT), the credit amounts allocated to the qualified small business employer pursuant to Main Street I.
- If a qualified small business employer applied the credit under the PITL or CTL, or both, the tentative credit reservation amount received by the qualified small business employer pursuant to Main Street I.

To be eligible for the credit under Main Street I and II, the qualified small business employer was required to:

- Submit a timely application to the California Department of Tax and Fee Administration for a tentative credit reservation amount for the SBHC.
- Claim the credit on a timely filed original return.

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The Main Street II credit will be repealed on December 1, 2022. The Main Street I credit was repealed on December 1, 2021.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 150 (Assembly Committee on Budget, Chapter 82, Statutes of 2021), the companion bill to SB 150, among other things, under the PITL, the CTL and the SUT Law, allowed a qualified small business employer a SBHC, subject to receiving a tentative credit reservation for taxable year beginning on or after January 1, 2021, and before January 1, 2022. The amount of the credit is reduced if the qualified small business employer received a tentative credit reservation amount under RTC section 6902.8.

SB 1447 (Bradford, et al., Chapter 41, Statutes of 2020) allowed for taxable year beginning on or after January 1, 2020, and before January 1, 2021, a SBHC to a qualified small business employer that received a tentative credit reservation.

SB 150 (Senate Committee on Budget and Fiscal Review, 2021/2022), companion bill to AB 150 (Assembly Committee on Budget, Chapter 82, Statutes of 2021), relating to various credits and data sharing, was held by the Assembly Committee on Budget without further action as the provisions of the bill were incorporated into AB 150.

SB 194 (Senate Committee on Budget and Fiscal Review, 2021/2022) companion bill to this bill, AB 194 (Assembly Committee on Budget, Chapter 55, Statutes of 2021), relating to various credits and penalties, was held by the Senate Committee on Budget and Fiscal Review without further action as the provisions of the bill were incorporated into this bill (AB 194).

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

Implementing Provision No. 2 would not significantly impact the department.

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ECONOMIC IMPACT*Revenue Estimate*

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 194 Provision No. 2 as Amended June 25, 2022
Assumed Enactment after June 30, 2022

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$2.5
2021-2022	-\$6.1
2022-2023	-\$6.8
2023-2024	-\$4.6
2024-2025	-\$2.9

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 data from the 2020 and 2021 taxable years, it is estimated that approximately \$50 million of Main Street I and Main Street II credits that would have been disallowed will now be allowed on amended and future returns. Of those, \$2.1 billion and \$3.6 billion, would use the credit in taxable years 2020 and 2021, respectively. The remainder would be used over the next 5 years.

The taxable year estimates are then converted to fiscal year estimates and reflected in the above table.

LEGAL IMPACT

None noted.

Amended June 25, 2022

Analysis Provision No. 3: HHTC (Sections 6 and 13)

This provision of the bill would, under the PITL and CTL, make the following changes to the HHTC:

- Modify the criteria of an "eligible individual," to a person who has received supportive services from a homeless services provider, as designated by a local continuum of care or a community-based service provider that is connected to the local coordinated entry system or to a local Homeless Management Information System (HMIS), on the date of the hire or any time during the 180-day period immediately before the hire.
- Allow an eligible individual to receive a new certification if they are homeless or have received supportive services from a homeless service provider, as specified, on the date that the eligible individual receives a new certification or anytime during the 180-day immediately before that date.
- Remove the requirement that a qualified taxpayer claim the credit on a timely filed return.
- Remove the requirement that a qualified taxpayer request a credit reservation from the FTB within 30 days of complying with the Employment Development Department's new hire reporting requirements. Instead, a qualified taxpayer would be required to obtain a credit reservation for an eligible individual from the FTB, either:
 - Within 30 days of hiring an eligible individual, or;
 - Within 60 days of receiving a new certification.

Effective/Operative Date

As a provision within a bill providing for appropriations relating to the Budget Bill, this provision would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2022.

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, including individuals that are qualified Supplemental Security Income recipients, 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.

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State Law

The HHTC is available for taxable years beginning January 1, 2022, through December 31, 2026. Employers may receive \$2,500 to \$10,000 in a tax credit per eligible employee based on hours worked in the taxable year. Employers may claim up to \$30,000 of credit per taxable year. To be eligible, the employee must have a certificate issued by a continuum of care, or a community-based service provider that is connected to the local coordinated entry system or to a local HMIS and employers must make a tentative credit reservation with the FTB to claim the credit. A total of \$30 million of credit is available annually.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 150 (Assembly Committee on Budget, Chapter 82, Statutes of 2021), amongst other provisions, allowed a qualified taxpayer that employs an eligible individual to receive the HHTC.

AB 176 (Assembly Committee on Budget, Chapter 256, Statutes of 2021), amongst other provisions, clarified that an eligible homeless individual's certification would be issued in the form and manner determined by the FTB, and made other technical corrections.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department anticipates minimal costs to implement Provision No. 3.

Amended June 25, 2022

ECONOMIC IMPACT

Revenue Estimate

Provision No. 3 of the bill as amended on June 25, 2022, would not change the manner in which the income or franchise tax is calculated under the RTC.

LEGAL IMPACT

None noted.

Analysis Provision No. 4: CCTC Extension (Sections 7 and 14)

This provision of the bill would, under the PITL and the CTL, extend the CCTC allocations through the 2027-2028 fiscal year; and for each of the 2022-2023 to 2027-2028 fiscal years, inclusive, would allow the aggregate credit allocation of \$180 million per fiscal year. This provision would also authorize the DOF to increase the aggregate credit allocation amount by up to \$25 million per fiscal year.

For allocation periods beginning with the 2023-2024 fiscal year, this provision would also add factors to the existing factors GO-Biz may consider when allocating the CCTC to businesses.

This provision would specify that information the FTB or GO-Biz obtains through the administration of the CCTC would be subject to the general prohibition against disclosure of confidential tax information. However, the provision provides an exception to the general prohibition against disclosure for the FTB and GO-Biz to disclose information to each other for the purpose of administering the CCTC.

Effective/Operative Date

As a provision within a bill providing for appropriations related to the Budget Bill, this provision would be effective and operative for taxable years beginning on or after January 1, 2022.

Federal/State Law

Federal Law

No comparable provision in federal law.

Amended June 25, 2022

State Law

For taxable years beginning on or after January 1, 2014, and before January 1, 2030, the CCTC is an income or franchise tax credit available to businesses that come to California or stay and grow in California. In addition to CCTC amounts determined pursuant to the section, the DOF may also increase the aggregate amount of the CCTC to be allocated by up to \$25 million per each fiscal year for fiscal years 2022–2023 through 2027–2028.

CCTC agreements are negotiated by the GO-Biz and approved by the CCTC Committee, consisting of the State Treasurer, the Director of the DOF, the Director of GO-Biz, and one appointee each by the Speaker of the Assembly and Senate Committees on Rules.

Upon approval of the tax credit agreement by the CCTC 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 complies 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.

If a taxpayer fails to satisfy the terms of their written CCTC agreement, GO-Biz is required to notify the FTB of the amount of the CCTC to be recaptured from the taxpayer. Any recapture, in whole or in part, is treated as a mathematical error appearing on the return, and is added to the tax otherwise due by the taxpayer for the taxable year in which the CCTC Committee's recapture determination occurs.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

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LEGISLATIVE HISTORY

AB 150 (Assembly Committee on Budget, Chapter 82, Statutes of 2021), the companion bill to SB 150 (Senate Committee on Budget and Fiscal Review, 2021/2022), among other things, under the PITL and the CTL, increased the amount of the CCTC allocated for the 2021-22 fiscal year.

SB 151 (Senate Committee on Budget and Fiscal Review, Chapter 74, Statutes of 2021), companion bill to AB 151 (Assembly Committee on Budget, 2021/2022), among other things, under the GC, created Article 4.4, the California Competes Grant (CCG) Program, and requires the FTB to review the books and records of any qualified grantee that is allocated a CCG, and, under the Administration of Franchise and Income Tax Law (AFITL), created Article 8, Collection of Recaptured CCGs, and requires the FTB to collect recaptured CCG amounts.

SB 855 (Senate Committee on Budget and Fiscal Review, Chapter 52, Statutes of 2018), among other things, extended the sunset date for the CCTC from taxable years beginning before January 1, 2025, to taxable years beginning before January 1, 2030, with the repeal date of December 1, 2030.

AB 151 (Assembly Committee on Budget, 2021/2022), the companion bill to SB 151, would have, under the GC, among other things, created Article 4.4, the CCG Program, and required the FTB to review the books and records of any qualified grantee that is allocated a CCG, and would, under the AFITL, have created Article 8, Collection of Recaptured CCGs, and required the FTB to collect recaptured CCG amounts. AB 151 was held by the Senate Committee on Budget and Fiscal Review without further action as the provisions of that bill were incorporated into SB 151.

SB 150 (Senate Committee on Budget and Fiscal Review, 2021/2022), companion bill to AB 150 (Assembly Committee on Budget, Chapter 82, Statutes of 2021), relating to various credits and data sharing, was held by the Assembly Committee on Budget without further action as the provisions of the bill were incorporated into AB 150.

SB 313 (Durazo, 2021/2022) would have, under the PITL and the CTL, modified the CCTC to be refundable for qualified taxpayers that reinvest the refund in immobile capital equipment that supports infrastructure improvements, expansion, or developments for media production facilities in the state. SB 313 was held in the Senate Governance and Finance Committee without further action.

PROGRAM BACKGROUND

None noted.

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FISCAL IMPACT

Implementing Provision No. 4 would not significantly impact the department.

ECONOMIC IMPACT

Revenue Estimate

Staff defers to the DOF to determine the revenue impact of Provision No. 4 of the bill.

Revenue Discussion

The amount and timing of the additional tax credits would be allocated by GO-Biz, under Provision No. 4 of this bill, and would be subject to the private equity share agreements between GO-Biz and taxpayers. Staff defers to the DOF for the estimated revenue loss for this credit.

LEGAL IMPACT

None noted.

Analysis Provision No. 5: PPPEA of 2021 (Sections 8, 15, 16, and 19)

This provision of the bill, under the PITL and CTL, would extend the exclusion from gross income of PPP covered loan amounts that are forgiven under California's current conformity to certain federal provisions, which includes the PPP established by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Public Law (PL) 116-136), modified by the Paycheck Protection Program and Health Care Enhancement Act (PL 116-139), the Paycheck Program Flexibility Act of 2020 (PL 116-142), and the Consolidated Appropriations Act, 2021 (CAA) (PL 116-260), for taxable years beginning on or after January 1, 2019.

This provision would provide those loans made during the PPPEA of 2021's extended period, from March 31, 2021, through June 30, 2021, and subsequently forgiven, would be eligible for the same exclusion from gross income and the same exceptions to the deduction, tax basis, and attributes provisions applicable to covered loans forgiven under the federal acts.

This bill contains a provision that the benefits authorized by this provision would not constitute a gift of public funds.

Effective/Operative Date

As a provision within a bill providing for appropriations relating to the Budget Bill, this provision would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2022.

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Federal/State Law

Federal Law

Under section 1106 of the CARES Act, a recipient of a covered loan made during the covered period of February 15, 2020, to June 30, 2020, under the PPP is eligible for forgiveness of indebtedness on the loan in an amount generally equal to the sum of certain costs incurred and payments made during either the eight-week or 24-week period beginning on the date of the origination of the covered loan, including payroll costs, certain mortgage interest payments, certain rent payments and certain utility payments. The CARES Act specifically excluded the income resulting from the discharge of PPP loans from gross income for federal purposes under section 1106 of the CARES Act (pursuant to the authority of Title 15 United States (US) Code 636(a)(7)).

The Paycheck Protection Program Flexibility Act of 2020 (PL 116-142) amended the CARES Act and the Small Business Act to modify certain provisions related to loan forgiveness under the PPP, among other provisions and extended the covered period to December 31, 2020.

The CAA extended the covered period from December 31, 2020, to March 31, 2021, and provided a "second draw" for certain businesses under the PPP. In addition to the loan forgiveness itself being excluded from gross income, payroll and certain non-payroll expenses paid with loan monies were deductible. Additionally, no basis or tax attribution adjustments were required with respect to the underlying expenses. The PPPEA of 2021 extends the covered period of the PPP to June 30, 2021.

State Law

For taxable years beginning on or after January 1, 2019, California excludes from gross income PPP loan forgiveness and certain Economic Injury Disaster Loan (EIDL) forgiveness, and partially conforms (AB 1577 Stats. 2020 Ch. 39 and AB 80 Stats. 2021 Ch. 17) to the CARES Act and the CAA relating to the:

- Exclusions from gross income for PPP loan forgiveness and certain EIDL loan forgiveness,
- Allowance of deductions for expenses paid with the forgiven loan amounts not included in income under such sections, and
- Allowance of tax basis increases and not requiring tax attribute reduction as a result of those forgiven loan amounts being excluded from gross income.

The Legislative Analyst's Office (LAO) may request information from the FTB for purposes of reviewing publicly available data and to analyze whether the PPP loans and the tax benefits of the deductions, tax basis, and other attributes were distributed evenly to those businesses harmed by COVID-19. FTB would be required to provide any available data requested by the LAO under the exception to the general prohibition against disclosure of confidential taxpayer information.

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Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

AB 80 (Burke, Chapter 17, Statutes of 2021), under the PITL and CTL, extended the current exclusion from gross income of covered loan amounts that are forgiven under the PPP established by section 1106 of the CARES Act, modified by the Paycheck Protection Program and Health Care Enhancement Act, the Paycheck Program Flexibility Act of 2020, and the CAA, from taxable years beginning on or after January 1, 2020, to taxable years beginning on or after January 1, 2019.

AB 1577 (Burke, Chapter 39, Statutes of 2020), under the PITL and the CTL, provided an exclusion from gross income covered loan amounts forgiven pursuant to the federal CARES Act, Paycheck Protection Program and Health Care Enhancement Act, or the Paycheck Protection Program Flexibility Act of 2020 for taxable years beginning on and after January 1, 2020.

PROGRAM BACKGROUND

The PPP provides forgivable loans to businesses to fund payroll costs including benefits for the covered period that begins on the date of origination and ends either with the eight-week or 24-week period after the date of origination of a covered loan or 10 months after the last day of the covered period, whichever is earlier. Funds can also be used to pay interest on mortgages, rent, and utilities. These loans are implemented by the Small Business Administration (SBA) to help businesses keep their workforce employed during the Coronavirus (COVID-19) crisis.

As relevant to the PPP, according to the SBA's website, loan forgiveness is based on the employer rehiring and maintaining employees and their salary levels. Forgiveness will be reduced if full-time headcount declines, or if salaries and wages decrease.

FISCAL IMPACT

Provision No. 5 would not significantly impact the department's costs; however, the changes proposed in this bill could result in additional amended returns being filed by impacted taxpayers that have already filed a tax return prior to enactment.

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ECONOMIC IMPACT*Revenue Estimate*

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 194 Provision No. 5 as Amended June 25, 2022
Assumed Enactment Prior to June 30, 2022

(\$ in Millions)

Fiscal Year	Revenue
2021-2022	-\$160
2022-2023	-\$160
2023-2024	-\$65
2024-2025	-\$34

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 US SBA PPP, California taxpayers received approximately \$5.1 billion in loans from PPP approved lending as a result of the PPPEA of 2021.

Under the PPP program, taxpayers were able to receive loans, up to specified amounts, to assist in paying certain business expenses during the COVID 19 restrictions. If those requirements were met, taxpayers could apply for the loan to be forgiven. The amount of loans forgiven are excluded from taxable income, but the expenses related to the loan amounts are no longer deductible. Provision No. 5 would allow eligible taxpayers to deduct expenses previously disallowed under the existing program, up to the amount of the loan forgiven.

It is estimated that approximately 95%, or \$4.8 billion, would be from participants who would apply for and receive loan forgiveness. It is expected that roughly 80% of that amount would be approved by the end of calendar year 2022.

Applying an average tax rate of 10%, the estimated revenue loss from allowing these expenses would be approximately \$480 million.

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It is expected that taxpayers would only be able to use about 60%, or \$280 million, in qualified expenses in the 2021 and 2022 taxable years. The remaining expenses would be carried forward to be used in future years as business losses.

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

LEGAL IMPACT

None noted.

Analysis Provision No. 6: Repealed Penalty and One-Time Penalty Abatement (Sections 9 and 10)

Repealed Penalty

This provision of the bill, under the RTC, would repeal the waiver for failure to pay penalty for qualified taxpayers impacted by the Northridge earthquake of January 1994, or any related aftershock, or any related casualty.

One-Time Penalty Abatement

This provision of the bill, under the RTC, would establish penalty abatement authority similar to the federal first-time abatement procedure, except that it would apply to individuals subject to the PITL only and would be a one-time abatement.

This provision would require the FTB, upon taxpayer request, either orally or in writing, to abate a failure-to-file or failure-to-pay penalty. The FTB would be required to abate the penalty when reasonable cause is either absent or the taxpayer chooses to forgo a reasonable cause review, and at the time the abatement request is made, the following apply:

- The taxpayer is otherwise compliant with their income tax filing requirements.
- The taxpayer has not previously been required to file a California PIT return or been granted abatement under this new section.
- The taxpayer has paid, or is current on an arrangement to pay, any tax, penalties, fees, and interest currently due, except for the timeliness penalty subject to the abatement request.

This provision would define “timeliness penalty” to mean a penalty imposed under RTC section 19131 (failure-to-file) or 19132 (failure-to-pay) for one taxable year with respect to a return filed by an individual for that taxable year. (Please see “State Law” below for additional detail on these penalties.)

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This provision also would provide the following:

- A timeliness penalty imposed and subsequently abated due to a determination of reasonable cause, or reasonable cause and not willful neglect, with respect to the taxpayer or the taxpayer's spouse, would not affect eligibility for the timeliness penalty abatement this provision would allow.
- A timeliness penalty would be considered imposed on the original due date of the return for the taxable year for which the penalty was imposed.

This provision would exempt from the Administrative Procedures Act any rule, guideline, or procedure prescribed by the FTB pursuant to this provision.

Effective/Operative Date

As a provision within a bill providing for appropriations relating to the Budget Bill, this provision would be effective immediately upon enactment and specifically operative for requests for abatement with respect to penalties incurred for taxable years beginning on or after January 1, 2022.

Federal/State Law

Federal Law

Current federal law imposes penalties for failing to timely file a tax return or to timely pay tax. The relevant penalties that apply to individuals include:

Failure-to-File Penalty

The penalty for failure to file an income tax return by the due date is 5% of the amount of tax required to be shown on the return, less any earlier payments or credits, for the first month the return is late. The penalty increases by 5%, to a maximum of 25%, for each additional month the return remains unfiled. The penalty is calculated as the lesser of \$100 or the amount of tax required to be shown on the return for failing to file within 60 days of the due date, including extensions.

Failure-to-Pay Penalty

The penalty for failing to pay the tax shown on an income tax return or an assessed deficiency by the due date is generally .5% of the tax due for the first month the payment is late, increasing by .5% per month that the balance remains outstanding to a maximum of 25%.

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First-Time Abatement Penalty Relief

Beginning in 2001, taxpayers requesting abatement of the failure-to-file, the failure-to-pay, and failure-to-deposit penalties may be granted relief under the IRS administrative practice of abating these penalties for taxpayers with a history of compliance. First-time abatement penalty relief is available under the IRS's general authority, rather than being allowed by statute or regulation.

In the IRS's modified first-time abatement policy, a reasonable cause explanation provided by the taxpayer will be considered after considering the first-time abatement analysis. If the analysis shows that the taxpayer is not eligible for penalty relief under first-time abatement, then the taxpayer's explanation will be used to determine if reasonable cause penalty relief criteria is met. For a taxpayer that is given relief under the first-time abatement, correspondence sent to the taxpayer states:

"We approved your request to remove the penalties. However, we only granted penalty relief because you have a good history of filing and paying on time. This type of penalty removal is only available one time. We will base our decisions to remove any future penalties on reasonable cause criteria."

The federal first-time abatement relief is generally available for any tax period if the taxpayer:

- Has not previously been required to file an income tax return or has no prior penalties, except the estimated tax penalty, for the preceding three years, and
- Has filed, or filed a valid extension for, all currently required returns and paid, or arranged to pay, any tax due. For example, a taxpayer would be considered current if they have an open installment agreement. If the taxpayer is not currently in compliance with this requirement and all other criteria are met, the taxpayer is provided the opportunity to fully comply before reasonable cause is considered. A penalty assessed and subsequently reversed in full will generally be considered to show compliance for that period.

Penalty relief can only apply to a single tax period. For example, if a request for penalty relief is being considered for two or more tax periods, the earliest tax period that meets the criteria will receive penalty relief, not all the tax periods being considered.

Amended June 25, 2022

Reasonable Cause Exception

Taxpayers have the right to ask that certain penalties be canceled if they can show that there was reasonable cause for failure to comply. For a penalty to be canceled, reasonable cause must exist. Reasonable cause means the act occurred despite the exercise of ordinary business care and prudence and the failure was due to events beyond the filer's control. Per the IRS website, some examples of what reasonable cause may be include:

- Fire, casualty, natural disaster, or other disturbances.
- Inability to obtain records.
- Death, serious illness, incapacitation or unavoidable absence of the taxpayer or a member of the taxpayer's immediate family.
- Other reason which establishes that you used all ordinary business care and prudence to meet your federal tax obligations but were nevertheless unable to do so.

State Law

Delinquent Filing Penalty/Late Filing Penalty (Section 19131)

The penalty for failure to file an income tax return by the due date is 5% of the amount of tax required to be shown on the return, less any earlier payments or credits, for the first month the return is late. The penalty increases by 5%, to a maximum of 25%, for each additional month the return remains unfiled. The penalty is calculated as the lesser of \$135 or the amount of tax required to be shown on the return for failing to file within 60 days of the due date, including extensions.

In case of fraudulent failure to file, the penalty is increased to 15% per month, up to a maximum of 75%.

Delinquent Payment Penalty/Late Payment Penalty (Section 19132)

The RTC explicitly requires the FTB to impose a penalty for a taxpayer's failure to timely pay tax, unless it is shown that the failure is due to reasonable cause and not due to willful neglect.

The RTC has no provision similar to the federal first-time abatement authority, nor does the FTB have any formal administrative policy that is similar to the federal policy for abatement of the timeliness penalties based on a taxpayer's history of compliance.

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Reasonable Cause Exception

In general, current state law generally conforms to the federal rules for determining reasonable cause.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

SB 1374 (Bradford, 2019/20) and SB 1082 (Bradford, 2017/2018), both substantially similar to this provision, would have established a one-time penalty abatement authority similar to the federal first-time abatement procedure for individual taxpayers. SB 1374 and SB 1082 did not pass out of the house of origin by the constitutional deadline.

SB 375 (Bradford, 2017/2018), would have established penalty abatement authority similar to the federal first-time abatement procedure for taxpayers subject to the PITL to apply for abatement up to every four years. SB 375 did not pass out of the house of origin by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

Staff estimates Provision No. 6 would cost approximately \$318,000 in fiscal year 2022-2023 and ongoing annual costs of approximately \$305,000 to develop and administer a first-time abatement program, program systems, and test revisions to existing systems.

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ECONOMIC IMPACT*Revenue Estimate*

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 194 Provision No. 6, One-Time Penalty Abatement, as Amended on June 25, 2022

Assumed Enactment After June 30, 2022

(\$ in Millions)

Fiscal Year	Revenue
2022-2023	-\$2.2
2023-2024	-\$8.9
2024-2025	-\$7.5

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

This estimate is based on FTB penalty data for failure to file a tax return and failure to timely pay the amount due. It is estimated that there will be \$84 million in penalties to be issued in tax year 2022. Of these amounts, it is estimated that approximately 20%, or \$17 million, would qualify for penalty relief and request abatement in tax year 2023. With each year of the program in place, the amount of qualifying penalties would decrease. The estimated penalty relief request amounts would be \$14 million in 2024, and \$9 million in 2025. Of these amounts, it is estimated that approximately 30% would have been collected in the year assessed, 15% one year after being assessed and would continue to decline each year thereafter. This results in an estimated revenue loss of \$7.2 million in 2023, and \$7.7 million in 2024.

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

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APPOINTMENTS (ALL PROVISIONS)

None noted.

SUPPORT/OPPOSITION (ALL PROVISIONS)

As per the Assembly Floor analysis of AB 194, dated June 28, 2022, there is no support or opposition on file for these provisions.

Provision No. 6 is supported by the Board.

ARGUMENTS (ALL PROVISIONS)

As per the same analysis, no arguments were noted.

LEGISLATIVE CONTACT

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