



Bill Analysis

Author: Ta

Sponsor:

Bill Number: AB 1565

Related Bills: See Legislative
History

Introduced: January 12, 2026

SUBJECT

Work Opportunity Tax Credit (WOTC)

SUMMARY

Under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), this bill would provide a WOTC to qualified taxpayers in an amount equal to 40 percent of qualified first-year wages, not to exceed \$5,000, paid or incurred to a qualified employee for taxable years beginning on or after January 1, 2027, and before January 1, 2032.

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to provide a tax credit for employing recently released convicted felons.

ANALYSIS

This bill, under the PITL and the CTL, for taxable years beginning on or after January 1, 2027, and before January 1, 2032, would allow a credit to qualified taxpayers equal to 40 percent of qualified first-year wages paid or incurred to a qualified employee, limited to \$5,000 for each qualified employee, regardless of the taxable year.

This bill would define the following terms:

“Qualified taxpayer” means a taxpayer with fewer than five employees that pays qualified first-year wages to a qualified employee.

“Qualified employee” means an individual who satisfies all of the following:

- Is employed by a qualified taxpayer during the taxable year.
- Has worked for the qualified taxpayer for at least six months.
- Has been convicted of a felony under any statute of the United States, or of any state.
- Is employed by the qualified taxpayer to perform services within the state of California.
- Has a hiring date that is not more than one year after the date the individual was convicted or was released from prison.

“Qualified first-year wages” means wages paid or incurred to a qualified employee within the one-year period beginning on the date the qualified employee begins performing services for the qualified taxpayer. “Qualified first-year wages” would not include the following:

- Amounts paid or incurred by a qualified taxpayer for any period to an individual for whom the qualified taxpayer received federally funded payments for on-the-job training of the individual for that period.
- Amounts paid or incurred by the qualified taxpayer to an individual for services which are the same as, or substantially similar to, those services performed by employees participating in, or affected by, a strike or lockout during the period of that strikeout or lockout.
- In the event that a qualified taxpayer pays or incurs qualified wages to a qualified employee in two separate taxable years, “qualified first-year wages” would not include any amount paid or incurred that was used to calculate the amount of any credit allowed in a prior year.

Any deduction otherwise allowed for wages paid or incurred by the qualified taxpayer to the qualified employee would be reduced by the amount of the credit allowed.

This credit would be required to be taken in lieu of any other credit that the qualified taxpayer may otherwise claim with respect to wages paid to a qualified employee.

The bill includes Revenue and Taxation Code (RTC) section 41 requirements. This bill would require the Franchise Tax Board (FTB) to report to the Legislature no later than December 1, 2029, and each year thereafter, on the number of taxpayers that received the credit, and the average dollar value of credits allowed.

The RTC section 41 reporting requirements would be treated as an exception to the general prohibition against disclosure of confidential taxpayer information.

The credit would be repealed on December 1, 2032.

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, 2027, and before January 1, 2032.

Federal/State Law

Federal Law

The 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 convicted of a felony who are hired within one year of conviction or release from prison. There is no limit on the number of individuals an employer can hire to qualify to claim the WOTC.

The amount of the WOTC that employers may claim 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. There is a maximum amount of WOTC that can be earned for each targeted group.

For the long-term family assistance recipient target group, the WOTC is available to employers who hire members of this group for up to a two-year period:

- In the first year, the employer may claim a tax credit equal to 40 percent of the first-year wages, up to the maximum tax credit, if the individual works at least 400 hours.
- In the second year, the employer may claim a tax credit equal to 50 percent of the second-year wages, up to the maximum tax credit, if the individual works at least 400 hours.

For all other target groups, the WOTC is available to employers who hire members of these groups, based on the individual's hours worked and wages earned in the first year:

- If the individual works at least 120 hours, the employer may claim a tax credit equal to 25 percent of the individual's first-year wages, up to the maximum tax credit.
- If the individual works at least 400 hours, the employer may claim a tax credit equal to 40 percent of the individual's first-year wages, up to the maximum tax credit.

The Consolidated Appropriations Act, 2021 (Public Law 116-260), extended the federal WOTC until December 31, 2025, and applies to individuals who begin working for employers after December 31, 2020.

State Law

For taxable years beginning on or after January 1, 2014, and before January 1, 2026, 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 economic development area. The qualified employee must meet one of the following conditions:

- Previous unemployment.
- Veteran status.
- Recipient of the federal Earned Income Tax Credit.
- Ex-offender convicted of a felony.
- Recipient of specified government assistance.

For taxable years beginning on or after January 1, 2023, and before January 1, 2026, the NEC was expanded by providing that the designated census tract or economic development area requirements do not apply to certain qualified taxpayers engaged in the following industries:

- Semiconductor manufacturing
- Semiconductor research and development
- Electric airplane manufacturing
- Lithium production
- Manufacturing of lithium batteries

Implementation Considerations

The FTB has identified the following considerations and is available to work with the author's office to resolve these and other considerations that may be identified.

This credit would be allowed for the employee's first year of wages paid (regardless of taxable year) if the employee worked for the taxpayer for at least 6 months. Wages paid or incurred during the employee's first taxable year could span multiple taxable years. Similarly, the employee's employment period could span multiple taxable years. This could complicate return filing. A calendar year taxpayer that pays or incurs wages for an employee who starts work in November 2026, and continues working through November 2027, may have already claimed deductions for wages on their 2026 taxable year return before the employee became a qualified employee after 6 months of employment. If the credit is allowed for the employee's first year of wages, which would include November and December 2026, the taxpayer may need to file

an amended return to reduce deductions taken in the 2026 taxable year in order to claim the credit in the 2027 taxable year. This could be administratively complicated for taxpayers and the FTB.

This bill requires the FTB to report on the performance of the credit allowed by this bill on or before December 1, 2029. For a report that contains complete information for the 2027 taxable year, it is recommended that the reporting due date be extended to July of 2030. If the reporting due date remains unchanged, the report would include the information available as of six months prior to the report due date, which would exclude taxpayer information for those filing on extension.

Technical Considerations

For consistency of terminology, the following changes are recommended:

- In Section 17053.10(b)(3)(B)(iii) and Section 23621.1(b)(3)(B)(iii), replace the words "prior year" with "prior taxable year." For example, "In the event that a qualified taxpayer pays or incurs qualified wages to a qualified employee in two separate taxable years, 'qualified first-year wages' shall not include any amount paid or incurred that was used to calculate the amount of any credit allowed in a prior taxable year."
- In Section 17053.10(d)(2)(A) and Section 23621.1(d)(2)(A), replace "that receive a credit" with "are allowed a credit." For example, "No later than December 1, 2029, and each December 1 thereafter, the FTB shall submit a report, in compliance with Section 9795 of the Government Code, to the Legislature detailing the number of taxpayers that are allowed a credit pursuant to this section or Section 23621.1 and the average dollar value of credits allowed."

Policy Considerations

This credit would be required to be taken in lieu of any other credit that the qualified taxpayer may otherwise claim with respect to wages paid to a qualified employee. This clause would limit the ability of a taxpayer to claim any other work or employment related credit if the employees qualifying for the other credit met the definition of a qualifying employee under this bill. This may lead to the denial of larger employment related credits, which in turn may have the unintended impact of limiting the hiring of qualified employees under this bill if it limits the qualified taxpayer's ability to claim a larger credit. If this is contrary to the author's intent, the in-lieu language may be replaced by a credit limitation to avoid unintended interactions with other tax credits while not providing a double benefit.

In addition, this bill does not provide a carryover period. As a result, any unused credit would be lost if the taxpayer is unable to use the entire credit amount in the taxable year claimed. The author may wish to add language to allow a carryover period.

LEGISLATIVE HISTORY

AB 231 (Ta, 2025/2026) and AB 2128 (Ta, et al., 2023/2024), identical to this bill, would have created a WOTC under the PITL and CTL. AB 231 and AB 2128 did not pass out of the Assembly by their required deadlines.

AB 2294 (Schiavo, 2023/2024), under the PITL and CTL, would have modified the existing NEC to remove the requirement that work be performed in a designated census tract or economic development area, and would have expanded the definition of a qualified full-time employee. AB 2294 did not pass out of the Assembly by the required deadline.

SB 553 (Limon, 2021/2022) would, under the PITL and CTL, have created a tax credit for certain employers that hired employees who are members of a targeted group. SB 553 did not pass out of the Senate by the required deadline.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1565 as Introduced on January 12, 2026
Assumed Enactment after June 30, 2026

Fiscal Year	Revenue
2026-2027	-\$150,000
2027-2028	-\$350,000
2028-2029	-\$350,000

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 California Department of Corrections and Rehabilitation and the Board of State and Community Corrections it is estimated that 40,000 ex-felons would be released from prison or jail in 2027. Of those it is estimated that approximately 60 percent, or 25,000, would be hired no more than one year after release. Of those hired, it is estimated that approximately 1 percent, or 250, would be hired by businesses with fewer than 5 employees and approximately 150 would work for a qualified employer for at least six months. This results in approximately \$2.5 million in qualified first-year wages paid to qualified employees. After applying the 40 percent credit rate and allowing for the \$5,000 credit cap, it is estimated that approximately \$700,000 of credit would be generated by qualified employers in the 2027 taxable year.

Of this amount, it is estimated that approximately 75 percent, including the S corporation adjustment, or \$525,000, would be earned by taxpayers with sufficient tax liability to offset with the credit. Of that amount, approximately 60 percent, or \$315,000 would be claimed in the year generated. Any remaining credit would go unused.

To arrive at the offsetting tax effect of wage expense deduction that would otherwise be allowed under current law, it is estimated that qualified taxpayers would be able to deduct approximately \$315,000 of qualified expenses in the 2027 taxable year. Applying an average tax rate of 7 percent to the wage expense and adjusting for credits that would have otherwise been claimed, results in an offsetting revenue gain of \$22,000. The resulting net revenue loss would be approximately \$300,000 in the 2027 taxable year.

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.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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