DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 06/21/2012
POSITION: Oppose

BILL NUMBER: SB 1179
AUTHOR: Walters, Mimi

BILL SUMMARY: Income taxes: credit: manufacturers.

This bill provides a $3,000 tax credit to a taxpayer, primarily in the surgical appliance and supplies manufacturing business, for each disabled veteran hired, and limits the cumulative total of credits allowed at $25 million.

FISCAL SUMMARY

According to the Franchise Tax Board (FTB), this bill would result in revenue losses of $200,000 in 2012-13, $600,000 in 2013-14, and $800,000 in 2014-15. However, as currently drafted, due to an omission in the language, the estimate of the revenue loss associated with this measure is understated.

FTB notes, there will be additional costs to the Department for revising tax forms and instructions, making changes to tax return processing systems and procedures, and monitoring the credit to ensure the $25 million is not exceeded. These costs which will be identified as the bill proceeds through the legislative process and an appropriation will be requested.

COMMENTS

Finance is opposed to this measure. While providing incentives to employ those who have been in service for this nation is a worthwhile cause, we also recognize the need to conserve scarce resources at a time when the state is facing a large budget deficit. This bill would result in revenue loss and unfunded implementation costs to the state at a time when revenues are scarce and costs need to minimized.

ANALYSIS

1. Programmatic Analysis

   Under existing federal and state law, various tax credits are provided to bring tax relief to taxpayers who incur certain expenses or to influence behavior, including business practices and decisions. These tax credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not generally undertake.

   Under federal law, the Work Opportunity Tax Credit (WOTC) program, an employer could receive a tax credit of 40 percent of the qualified first-year wages of employees within a targeted group, which includes veterans. The amount of the credit provided for the employment of a qualified veteran could vary from $6,000 for a veteran who is either on food stamps or was on unemployment from four weeks to six months, to $24,000 for a qualified veteran entitled to compensation for service related disability and has been unemployed for a period of six months in the year leading up to his hiring.

   Existing federal law provides special tax incentives for empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

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ANALYSIS (continued)

Existing state law provides for several types of geographically targeted economic development areas (G-TEDAs): Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs). Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within a G-TEDA including a hiring credit. A business located in a G-TEDA is eligible for a hiring credit equal to a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as a G-TEDA and meet certain other criteria. At least 90 percent of the qualified employee's work must be directly related to a trade or business located in the G-TEDA and at least 50 percent of the employee's services must be performed inside the G-TEDA. The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current minimum hourly wage (under special circumstances for the Long Beach EZ, the maximum is 202 percent of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit. Any credits not used in the taxable year may be carried forward until they are exhausted.

Under existing state law, the New Jobs Credit enacted in 2009 provides a credit of $3,000 for a qualified employer who hires a qualified full-time employee for tax years beginning on or after January 1, 2009. The credits are allocated on a first-come-first-served basis by the FTB and are limited to a cumulative total of $400 million for all tax years. The credits are allowed only for credits claimed on timely filed original returns received by the cut-off date established by the FTB. The cut-off date is the last day of the calendar quarter within which the FTB estimates it will have received timely filed original returns claiming credits that cumulatively total $400 million. A penalty for the underpayment of estimated tax or underpayment of tax would not be made if the underpayment was created or increased by disallowance of the credit. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed as of that date. Unused credits in the taxable year may be carried forward up to eight years.

Qualified employees do not include an employee certified as a qualified employee in an EZ, MEA, TTA, or a certified qualified disadvantaged individual or a qualified displaced employee in a LAMBRA.

As of May 7, 2012, the total amount of New Jobs Credits generated on a combined total of 18,429 Personal Income Tax and Business Entity tax returns was $113.9 million out of a possible $400 million limit.

This bill would, beginning on or after January 1, 2013, provide a tax credit of $3,000 for each net increase in qualified full-time employees hired during the taxable year by a qualified employer.

"Qualified employer" means a taxpayer who is primarily engaged in the business of Surgical Appliance and Supplies Manufacturing as classified under Code 339113 of the North American Industry Classification System (NAICS), 2012 edition.

"Qualified full-time employee" means a disabled veteran as defined in Section 999 of the Military and Veteran Code who was paid qualified wages during the taxable year by the qualified employer for an average work week of not less than 35 hours, or was a salaried employee and was paid compensation during the taxable year for full-time employment as defined in Section 515 of the Labor Code.

ANALYSIS (continued)

"Qualified employee" would not include an employee certified as a qualified employee in an EZ, or TTA, an employee certified as a qualified disadvantaged individual in a MEA, or an employee whose wages are included in calculating any other credit allowed.

"Annual full-time equivalent" means either of the following: In the case of a full-time employee that is paid hourly, the total number of hours worked for the taxpayer by the employee (not to exceed 2000 hours) divided by 2000; or in the case of a salaried full-time employee, the total number of weeks worked for the taxpayer divided by 52.

"Qualified wages" means wages subject to Division 6 of the Unemployment Insurance Code.

The "net increase in qualified employees" of a qualified employer would be determined on an annual full-time equivalent basis by subtracting from the number of qualified full-time employees employed in the current taxable year, the total number of qualified full-time employees employed in the previous taxable year.

Finance notes that as currently drafted, this bill defines the net increase in the number of qualified full-time employees as the difference between the total number of full-time employees employed in the current taxable year minus the total number of qualified full-time employees employed in the preceding taxable year. This definition is in error as it would qualify non-qualified full-time employees for the credit. To remedy this problem Finance recommends the following amendment: page 3, line 26 of the current amended version add "qualified", it should read " The total number of *qualified* full-time employees employed...". For those employers who commenced doing business in this taxable year the number of qualified full-time employees employed in the previous taxable year is zero.

Any deduction an employer is allowed for qualified wages would not be reduced by the amount of the credit allowed by this bill. Credits would be allowed only when claimed on a timely filed original tax return by the cut-off date, which would be the last day of the calendar quarter within which the FTB estimates it will have received timely filed returns claiming the cumulative limit of $25 million in credits.

The determination of the cut-off date, the date a return is received, and whether a return has been timely filed, will be determined by the FTB and may not be reviewed by any administrative or judicial proceeding. The disallowance of a credit because the $25 million limit has been reached will be treated as a math error and will may not be subject to review by any administrative or judicial proceeding.

The FTB is required to periodically provide detail on its Internet Website with respect to the amount of credits claimed on timely filed returns. The FTB may also prescribe rules, guidelines, or procedures necessary to carryout the provisions of this bill.

This credit is to remain in effect until December 1 of the calendar year after the year of the cut-off date, and will be repealed as of that date.

No additional tax shall be made with respect to any underpayment of an installment if that underpayment was created or increased by the disallowance of a credit because the cumulative credit limit was reached.

This bill would take effect immediately as a tax levy.

BILL ANALYSIS--(CONTINUED)		Form DF-43
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ANALYSIS (continued)

2. Fiscal Analysis

According to the FTB, this bill would result in revenue losses of $200,000 in 2012-13, $600,000 in 2013-14, and $800,000 in 2014-15. However, as currently drafted, due to an omission in the language, the estimate of the revenue loss associated with this measure is understated.

FTB notes, there will be additional costs to the department for revising tax forms and instructions, making changes to tax return processing systems and procedures, and monitoring the credit to ensure the $25 million is not exceeded. These costs which will be identified as the bill proceeds through the legislative process and an appropriation will be requested.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2012-2013	FC	2013-2014	FC	2014-2015	Fund Code
1104/Corp Tax	RV	No	U	-200	U	-600	U	-800	0001
1730/FTB	SO	No		----- See Fiscal Summary -----					0001