DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: RN 11 24039 to July 11, 2011
POSITION: Oppose

BILL NUMBER: SB 364
AUTHOR: L. Yee
RELATED BILLS: SB 508

BILL SUMMARY: Income Taxes: Business Tax Credits-Reporting & Penalty

This bill would require a qualified taxpayer doing business in California that claims a business tax incentive or credit after January 1, 2012, that is based on employee compensation, to report employment information to the Franchise Tax Board (FTB). A penalty would be assessed if there is specified net decrease in its employees, or if the required employment information is not provided.

FISCAL SUMMARY

According to the FTB, this bill would not impact the state's income tax revenue because provisions of current tax law regarding business tax law incentives remain unchanged. With respect to future tax proposals, without knowing what they are their revenue impacts cannot be determined.

The FTB notes that there will be additional costs to the FTB for printing, processing, and storage of tax returns. At the time that this analysis was prepared, preliminary discussions with staff at the FTB indicated that start-up costs could be in the range of $250,000, and ongoing costs for administering the reporting and penalty requirements could be in the range of $20,000 annually.

SUMMARY OF CHANGES

Amendments to this bill since our analysis of the July 11, 2011 version are minor and do not alter our position.

COMMENTS

Finance is opposed to this bill for the following reasons:

- This bill imposes a blanket one size fits all penalty on future tax expenditures, which may not be appropriate in all cases. For example, businesses in an incubation stage may not be able to meet the annual employment criteria of this bill in order to avoid the penalty even though the purpose of the credit is to assist the new industry.

- Recapture provisions can already be added to tax incentive bills for the purpose of mitigating or eliminating gaming or abuse of the incentive.

- The FTB could incur significant set-up and ongoing costs to administer the reporting and penalty requirements of the bill even if the bill's provisions are never implemented.

Analyst/Principal (0724) R. Lawrence	Date	Program Budget Manager Mark Hill	Date
Department Deputy Director			Date
Governor's Office:	By:	Date:	Position Approved_______ Position Disapproved

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ANALYSIS

A. Programmatic Analysis

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption), or to a particular group (e.g. seniors or families with children), or to influence behavior, including business practices and decisions (e.g., research credit), which generally provide incentives for taxpayers to perform various actions or activities which they may not otherwise undertake.

Reporting requirement on employment

This bill would require a qualified taxpayer doing business in this state that claims any business tax credit, beginning on or after January 1, 2012, to annually submit certain employee information to the FTB. The information must be on a timely filed original return and include the number of full-time equivalent employees employed by the taxpayer in the state for the current and prior taxable year. The aggregate employee count must include employees of a trade or business acquired by the taxpayer, and exclude employees of a trade or business that has been disposed.

This bill provides the following definitions:

- "Annual full-time equivalent" means either of the following:
  - In the case of an employee paid hourly qualified wages, "annual full-time equivalent" means the total number of hours worked for the qualified taxpayer by an employee (not to exceed1,820 hours per employee) divided by 1,820.
  - In the case of a salaried employee, "annual full-time equivalent" means the total number of weeks worked for the qualified taxpayer by an employee divided by 52. Where the taxable years being reported for hourly or salaried employees is less than 12 months, the hours or weeks must be adjusted so that the full time equivalent is 12 months.

- "Business tax credit" means a credit that is based on qualified wages or the number of persons employed against the "net tax" as defined in specified code sections.

- "Qualified taxpayer" means a person that is engaged in or carrying on a trade, business, profession, vocation, calling ,or commercial activity, in the state, and that pays qualified wages to more than 100 annual full-time equivalent employees in this state.

- "Qualified wages" means wages subject to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.

Penalty for decrease in employment and/or failure to comply with reporting requirement

This bill would assess a penalty if the qualified taxpayer that claims a tax credit has a net decrease in the number of annual full-time equivalent employees equal to or greater than 10 percent of the number employed in the prior taxable year. The penalty would be computed as follows:

- Ninety percent of the annual full-time equivalents, including any fractional portion thereof, for the prior taxable year, less

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- The annual full-time equivalents, including any fractional portion thereof, for the current taxable year, multiplied by
- Five thousand dollars ($5,000) per annual full-time equivalent, including any fractional portion thereof, as computed above.
- The amount of the penalty is limited to the amount of business credits that benefitted the qualified taxpayer, or business tax credits claimed by the qualified taxpayer as reflected in tax returns for the three preceding taxable years.

This bill would impose a $5,000 penalty for the failure to provide the required employee information unless that failure is due to reasonable cause and not due to willful neglect.

The FTB may prescribe the necessary rules, guidelines, and procedures to carry out the provisions of this measure.

Related bill:

SB 508 as amended June 20, 2011, would create new requirements for bills introduced on or after January 1, 2012, that create a new personal income or corporate tax credit. Specifically, new tax credit bills would be required to include statements of specific goals, purposes, and objectives of the credit as well as detailed performance measures and data collection and reporting.

B. Fiscal Analysis

According to the FTB, this bill would not impact the state's income tax revenue because provisions of current tax law regarding business tax law incentives remain unchanged. With respect to future tax proposals, without knowing what they are their revenue impacts cannot be determined.

The FTB notes that there will be additional costs to the FTB for printing, processing, and storage of tax returns. At the time that this analysis was prepared, preliminary discussions with staff at the FTB indicated that start-up costs could be in the range of $250,000, and ongoing costs for administering the reporting and penalty requirements could be in the range of $20,000 annually.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	2011-2012 (Fiscal Impact by Fiscal Year) (Dollars in Thousands)	FC	2012-2013	FC	2013-2014	Fund Code
1104/Corp Tax	RV	No		-------------------- See Fiscal Analysis ---------------------					0001
1147/Pers Inc Tax	RV	Yes		-------------------- See Fiscal Analysis ---------------------					0001
1730/FTB	SO	No		--	C	$250	C	$20	0001