

Date of Hearing: August 30, 2020

ASSEMBLY COMMITTEE ON REVENUE AND TAXATION

Autumn R. Burke, Chairwoman

SB 1447 (Bradford) – As Amended August 27, 2020

Majority vote. Tax levy. Fiscal committee.

**SENATE VOTE:** 39-0

**SUBJECT:** Income tax: sales and use tax: credit: small business

**SUMMARY:** Allows, for each taxable year beginning on or after January 1, 2020, and before January 1, 2021, a small business hiring credit to a "qualified small business employer" that receives a tentative credit reservation. Specifically, **this bill:**

- 1) Provides that the credit shall equal \$1,000 for each net increase in "qualified employees", as specified. The credit, however, is capped at \$100,000 per "qualified small business employer".
- 2) Defines a "qualified small business employer" as a taxpayer meeting both of the following requirements:
  - a) Employed 100 or fewer employees as of December 31, 2019; and,
  - b) Experienced a 50% decrease in gross receipts determined by comparing gross receipts for the three-month period beginning on April 1, 2020, and ending June 30, 2020, with the gross receipts for the three-month period beginning on April 1, 2019, and ending June 30, 2019, if it would have met the requirement of having a significant decline in gross receipts for that quarter as determined under Section 2301(c)(2)(B)(i) of Public Law 116-136.
- 3) Provides that a "qualified small business employer" does not include a taxpayer required to be included in a combined report under Revenue and Taxation Code (R&TC) Section 25101 or 25110, or authorized to be included in a combined report under R&TC Section 25101.15.
- 4) Defines a "qualified employee" as an employee paid "qualified wages" by a qualified small business employer. A "qualified employee" shall not, however, include an employee whose wages are included in calculating any other credit allowed under the Personal Income Tax (PIT) Law or the Corporation Tax (CT) Law.
- 5) Defines "qualified wages" as wages subject to Unemployment Insurance Code Section 13000 *et seq.*
- 6) Provides that the net increase in qualified employees shall be determined by subtracting the amount determined in paragraph (a) from the amount determined in paragraph (b):

- a) The average "monthly full-time equivalent" qualified employees employed during the three-month period beginning April 1, 2020, and ending June 30, 2020, by the qualified small business employer. The average "monthly full-time equivalent" qualified employees shall be determined by adding the total "monthly full-time equivalent" qualified employees employed by the qualified small business employer for all three months and dividing the total by three; and,
  - b) The average "monthly full-time equivalent" qualified employees employed during the five-month period beginning July 1, 2020, and ending November 30, 2020, by the qualified small business employer. The average "monthly full-time equivalent" qualified employees shall be determined by adding the total "monthly full-time equivalent" qualified employees employed by the qualified small business employer for all five months and dividing the total by five.
- 7) Defines "monthly full-time equivalent" as either of the following:
- a) In the case of a qualified employee paid hourly qualified wages, "monthly full-time equivalent" means the total number of hours worked per month for the qualified small business employer by the qualified employee, not to exceed 167 hours per month per qualified employee, divided by 167; and,
  - b) In the case of a salaried qualified employee, "monthly full-time equivalent" means the total number of weeks worked per month for the qualified small business employer by the qualified employee divided by 4.33 multiplied by the "time base" the qualified employee worked.
- 8) Defines "time base" as the fraction of full-time employment that the qualified employee works.
- 9) Provides that, in cases where the credit amount exceeds the taxpayer's tax liability, the excess credit amount may be carried over to reduce the tax liability in the following year, and succeeding four years if necessary, until the credit is exhausted.
- 10) Provides that any deduction otherwise allowed for qualified wages shall be reduced by the amount of the credit allowed.
- 11) Provides that all employees of the trades or businesses that are treated as related under Internal Revenue Code Section 267, 318, or 707 shall be treated as employed by a single qualified small business employer.
- 12) Provides that a credit shall only be allowed on timely filed original returns.
- 13) Provides that the date a return is received shall be determined by the Franchise Tax Board (FTB).
- 14) Provides that the FTB's determination with respect to whether a return has been timely filed for purposes of this credit may not be reviewed in any administrative or judicial proceeding.

- 15) Provides that any disallowance of a credit claimed shall be treated as a mathematical error appearing on the return. Any amount of tax resulting from such disallowance may be assessed by the FTB in the same manner as provided by R&TC Section 19051.
- 16) Authorizes the FTB to prescribe any regulations necessary or appropriate to carry out the purposes of this credit. Specifically, the FTB may prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of this bill and the Administrative Procedure Act shall not apply to any regulation, rule, guideline, procedure, or other guidance prescribed by the FTB.
- 17) Authorizes the FTB, notwithstanding existing law, to provide information to the California Department of Tax and Fee Administration (CDTFA) related to the credit, including the qualified small business employer names, amounts of tax credits allowed, and the net increase in qualified employees.
- 18) Provides that the statutory provisions authorizing the income tax credit shall remain in effect only until December 1, 2021, and are repealed as of that date.
- 19) Directs CDTFA to allow a qualified small business employer that has made an irrevocable election pursuant to this bill to apply the small business hiring credit amount against "qualified sales and use taxes" imposed on the qualified small business employer, as follows:
  - a) For monthly filers, the credit shall apply to amounts due and payable for the month beginning on March 1, 2021, ending on March 31, 2021, and due April 30, 2021;
  - b) For quarterly filers, the credit shall apply to amounts due and payable for the quarter beginning on January 1, 2021, ending on March 31, 2021, and due April 30, 2021; and,
  - c) For annual filers, fiscal year filers, or a qualified small business owner on any other reporting basis, the credit shall apply to amounts due and payable on the first return due on or after April 30, 2021.
- 20) Defines "qualified sales or use taxes" as any sales and use taxes imposed by R&TC Section 6001 *et seq.* and Section 35 of Article XIII of the California Constitution, local sales and use taxes imposed in accordance with the Bradley-Burns Uniform Local Sales and Use Tax Law, and local transactions and use taxes imposed in accordance with the Transactions and Use Tax Law.
- 21) Provides that any excess credit applied to sales and use taxes shall be carried over and shall not be refunded, as follows:
  - a) In cases where the credit amount exceeds the sales and use taxes due and payable as described, CDTFA shall apply the excess credit against amounts due and payable for periods following those described in this bill on returns due and filed on or before April 30, 2026; and,
  - b) Any remaining excess credit amount after April 30, 2026, shall not be refunded and shall be forfeited.

- 22) Provides that R&TC Section 6961 shall apply to any credit, or part thereof, that is erroneously allowed under this bill.
- 23) Provides that, notwithstanding existing law, CDTFA shall provide information to the FTB, in a form and manner agreed upon by both parties, regarding the qualified small business employers that have been assigned a credit, and have made an irrevocable election, and the credit amount claimed by each qualified small business employer.
- 24) Authorizes CDTFA to prescribe, adopt, and enforce any emergency regulations as necessary to implement, administer, and enforce its duties under this bill. Any emergency regulation shall be adopted in accordance with the Administrative Procedure Act and, for purposes of that law, the adoption of the regulation is an emergency and shall be considered by the Office of Administrative Law as necessary for the immediate preservation of the public peace, health and safety, and general welfare. Additionally, notwithstanding any other law, the emergency regulations adopted by CDTFA may remain in effect for two years from adoption.
- 25) Establishes the Small Business Hiring Credit Fund in the State Treasury for the sole purpose of applying the small business hiring credit allowed by this bill. Any unused money remaining in the fund shall be transferred to the General Fund by June 1, 2026.
- 26) Directs qualified small business employers to submit an application to CDTFA, as specified, for a tentative credit reservation amount for the small business hiring tax credit allowed under the PIT Law, the CT Law, or both.
- 27) Specifies that the application shall include the following:
- a) The net increase in qualified employees;
  - b) Whether the credit will be applied under the PIT Law, the CT Law, or both;
  - c) Whether the qualified small business employer makes an irrevocable election to apply the credit against qualified sales and use taxes in lieu of claiming the credit allowed under the PIT or CT Laws; and,
  - d) Any other information deemed necessary by CDTFA.
- 28) Provides that qualified small business employers shall submit, and CDTFA shall accept, applications for tentative credit reservation amounts during the period beginning December 1, 2020, and ending January 15, 2021, or any earlier date determined by CDTFA when the maximum cumulative total allocation limit is reached.
- 29) Provides that applications shall not be accepted by CDTFA after January 15, 2021, or any other date determined by CDTFA. The date and time an application is received shall be determined by CDTFA. Additionally, the determination of CDTFA with respect to the date and time an application is received may not be reviewed in any administrative or judicial proceeding.

- 30) Provides that CDTFA shall allocate a tentative credit reservation to qualified small business employers on a first-come, first-served basis. For each application received, the total amount of credit available for allocation shall be reduced by an amount equal to the allocated tentative credit reservation amount.
- 31) Provides that the tentative credit reservation amount shall be equal to the net increase in qualified employees as reported on the application multiplied by \$1,000 and shall not exceed \$100,000 per qualified small business employer.
- 32) Directs CDTFA to promptly notify applicants, no more than 30 days after the application is received, of the tentative credit reservation amount. The amount allocated shall not constitute a determination by CDTFA with respect to any of the requirements of this bill or eligibility for the credit.
- 33) Requires CDTFA to periodically provide on its website the aggregate allocated tentative credit reservation amount, and remaining credit amount available for allocation.
- 34) Provides that, notwithstanding existing law, CDTFA shall provide the FTB, in the form and manner agreed upon by CDTFA and the FTB, any and all information provided by each applicant and any other information deemed necessary by CDTFA and the FTB to administer and enforce this bill.
- 35) Caps at \$100 million the aggregate amount of credit that may be allocated under this bill's provisions.
- 36) Provides that, in accordance with R&TC Section 41, the purpose of the small business hiring credit is to provide financial relief for the economic disruptions resulting from COVID-19 that have resulted in unprecedented job losses.
- 37) Provides that, to measure whether the credit achieves its intended purpose, the following performance indicators shall be used:
- a) The number of applications received for tentative credit reservation;
  - b) The net increase in number of qualified employees represented on applications for tentative credit reservation; and,
  - c) The average credit amount on tax returns claiming the credit.
- 38) Provides that, by April 1, 2022, or earlier if data are available, the FTB shall report to the Legislature the information above for credits claimed under the PIT Law and the CT Law and CDTFA shall report to the Legislature for credits claimed under the Sales and Use Tax Law. These reports shall be submitted in compliance with Government Code Section 9795.
- 39) Takes immediate effect as a tax levy.

**EXISTING LAW:**

- 1) Allows various tax credits under both the PIT Law and the CT Law. These credits are generally designed to encourage socially beneficial behavior or to provide relief to taxpayers that incur specified expenses.
- 2) Allows taxpayers engaged in a trade or business to deduct expenses considered ordinary and necessary in conducting that trade or business.
- 3) Imposes a sales tax on retailers for the privilege of selling tangible personal property (TPP), absent a specific exemption. The tax is based upon the retailer's gross receipts from TPP sales in this state.
- 4) Imposes a complimentary use tax on the storage, use, or other consumption of TPP generally purchased out-of-state and brought into California. The use tax is imposed on the purchaser; and unless the purchaser pays the use tax to an entity registered to collect California's use tax, the purchaser remains liable for the tax. The use tax is set at the same rate as the state's sales tax and must generally be remitted to the CDTFA.
- 5) Requires any bill introduced on or after January 1, 2020, that authorizes a new tax expenditure, to contain all of the following:
  - a) Specific goals, purposes, and objectives that the tax expenditure will achieve;
  - b) Detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets the goals, purposes, and objectives stated in the bill; and,
  - c) Specified data collection requirements to enable the Legislature to determine whether the tax expenditure is meeting, failing to meet, or exceeding those specific goals, purposes, and objectives.

**FISCAL EFFECT:** Unknown

**COMMENTS:**

- 1) Senator Bradford, who is a joint author of this measure, notes the following:

Since the start of the COVID-19 pandemic, many small businesses have been struggling to stay afloat. In May, McKinsey released data indicating that more than a third of vulnerable private-sector workers in California were employed by small businesses. Small businesses are vital not only as a way for hardworking individuals and their families to build wealth, but also as an engine of job growth. This is especially true of minority-owned and other diverse business enterprises. California has sought to assist struggling small businesses in a variety of complementary ways, including zero-interest sales and use tax deferrals. SB 1447 further assists small businesses by providing those that hire new employees with a tax credit that can also offset sales and use tax liabilities, helping them to persist through this state of emergency.

- 2) Assemblymember Cervantes, who is a joint author of this measure, notes the following:

Small business owners, especially women- and BIPOC\*-owners, have been especially hard hit in the economic fallout of the COVID-19 pandemic.

As businesses have closed, opened, closed, and tried to re-open again, small business owners have struggled to implement new e-commerce business practices, make lease payments, repay pre-COVID debt, meet payroll, and access and purchase PPE to keep workers and customers safe. While technically available, many California small businesses were denied or found to be ineligible to receive federal disaster grants and loans.

Small businesses [that] are unable to pivot to meet these new market dynamics, including retaining and hiring a workforce to support new models, will not survive. The impact of these small business closures will go well beyond the loss of a single business or place of work, and will have a rippling effect across the California economy. As the Legislature considers recovery proposals, bills like SB 1447 that address the needs of small businesses and their workers must be a priority. [\*BIPOC is an acronym that stands for Black, Indigenous, and People of Color.]

### 3) Committee Staff Comments:

- a) *California's existing hiring tax credit*: In 2013, Governor Brown signed legislation that reformed California's economic development policies. [AB 93 (Committee on Budget), Chapter 69, Statutes of 2013.] The new law eliminated enterprise zones and other geographically targeted economic development areas and, instead, created three new economic development tax incentives: (i) a temporary tax credit for wages paid by a taxpayer engaged in a trade or business within a designated census tract, as defined, or a former enterprise zone to certain full-time employees (the "New Employment Credit"); (ii) a temporary sales and use tax exemption on purchases of manufacturing equipment made by qualified taxpayers, capped at \$200 million annually per taxpayer; and (iii) the California Competes Tax Credit program - a negotiated incentive administered by the Governor's Office of Business and Economic Development.
- b) *The New Employment Credit*: Existing law provides a hiring tax credit for taxable years beginning on or after January 1, 2014, and before January 1, 2026. The credit is available to taxpayers that hire a qualified full-time employee and pay qualified wages attributable to work performed by that employee in a designated census tract or economic development area. The taxpayer must also receive a tentative credit reservation for that qualified full-time employee, and the credit may only be claimed on a timely filed original return.

The New Employment Credit is available for wages paid to certain full-time employees (e.g., ex-offenders previously convicted of a felony) who perform at least 50% of their activities in the designated areas. Additionally, the qualified full-time employee must receive starting wages that are at least 150% of the minimum wage.

Except for small businesses, certain employers are specifically prohibited from receiving this credit. For example, prohibited businesses include:

- i) Those providing temporary help services, as described in Code 561320 of the North American Industry Classification System (NAICS);
  - ii) Those providing retail trade services, as described in Sector 44-45 of the NAICS;
  - iii) Those primarily engaged in providing food services, as described in Code 711110, 722511, 722513, 722514, or 722515 of the NAICS; and,
  - iv) Sexually oriented businesses, as defined.
- c) *What would this bill do?* This bill would allow, for taxable years beginning on or after January 1, 2020, and before January 1, 2021, a "small business hiring credit" to qualified small business employers that apply for and receive a tentative credit reservation. This credit would be available to taxpayers filing under either the PIT Law or the CT Law. To qualify for the credit, however, the small business employer would have to meet two requirements: First, as of December 31, 2019, the employer must have employed 100 or fewer employees and, second, the employer must have experienced a 50% decrease in gross receipts. This calculation would be made by comparing 2020 Second Quarter gross receipts with 2019 Second Quarter gross receipts.

For qualifying taxpayers, the credit amount would equal \$1,000 for each net increase in qualified employees. This net increase, in turn, would be calculated by comparing the taxpayer's average number of employees for the Second Quarter of 2020, with the average number of employees for the five-month period beginning July 1, 2020, and ending November 30, 2020. The credit itself would be capped at \$100,000 per taxpayer.

Unlike the vast majority of income tax credits, this bill would also allow qualified small business employers to make an irrevocable election to apply the credit amount against qualified sales and use taxes imposed on the employer. This is likely being done to assist retailers that have limited income tax liability but do have sales and use tax liabilities for sales of TPP.

Finally, this bill caps at \$100 million the aggregate amount of credit that may be allocated under this bill's provisions.

- d) *How does this bill differ from the existing hiring credit?* As noted above, existing law already provides a hiring credit known as the New Employment Credit for taxable years beginning on or after January 1, 2014, and before January 1, 2026. The New Employment Credit is available to taxpayers that hire a qualified full-time employee and pay qualified wages attributable to work performed by that employee in a designated census tract or economic development area. The New Employment Credit differs from the credit this bill proposes in numerous respects, including the following:
- i) The New Employment Credit only applies with respect to work performed by employees in a designated census tract or economic development area. This bill's credit, in turn, would apply statewide and would not preference hiring that takes place in economically-depressed regions of the state;
  - ii) The New Employment Credit is only available for wages paid to certain full-time employees, in an effort to encourage the employment of "hard-to-hire" individuals.



Qualifying employees include those unemployed for six months immediately preceding employment, veterans who separated from service within the 12 months preceding employment, recipients of the federal Earned Income Tax Credit, ex-offenders previously convicted of a felony, and recipients of either CalWORKs or general assistance. This bill's credit, in turn, would apply to all employees without distinction;

- iii) The New Employment Credit specifies that a qualified full-time employee must receive starting wages that are at least 150% of the minimum wage. This bill's credit, in turn, includes no such requirement; and,
- iv) Except in the case of a "small business", defined as one with gross receipts of less than \$2 million, the New Employment Credit is not available to taxpayers engaged in specified lines of work. These excluded business categories include certain retail trade services, temporary help services, those primarily engaged in providing food services, and sexually oriented businesses. This bill's credit, however, makes no such distinctions.
- e) *Do hiring tax credits work?* In the wake of the Great Recession, some advocated job creation tax credits as a means of revitalizing the struggling economy. The question, however, is whether such credits actually work. Mr. Daniel Wilson, assistant director of the Center for the Study of Innovation and Productivity at the Federal Reserve Bank of San Francisco, attempted to answer this question. In a paper co-authored with Robert Chirinko of the University of Illinois at Chicago, Wilson examined the period between January 1990 and August 2009 and found that among states where employers could qualify for credits immediately after enactment of the credit legislation there was a slight employment increase of 0.12%. These findings suggest that hiring credits, at least at the state level, have some impact but appear to be a very blunt tool for stimulating job growth.
- f) *Incentive or assistance?* While hiring credits have a mixed track record of actually stimulating job growth, this bill does not appear to be primarily designed for this purpose. Indeed, this bill's "Section 41" provisions specifically note that the proposed credit is meant to provide *financial relief* for the economic disruptions resulting from COVID-19. This bill's primary aim can also be inferred from the way this bill's credit is calculated – namely, by comparing the taxpayer's net increase in employment from the Second Quarter of 2020, to the five-month period beginning July 1, 2020. Assuming this bill were to go into effect on September 1, 2020, it would still be conferring a tax benefit for hiring decisions that occurred for two months preceding its operative date and for which this credit would obviously not have provided an incentive.
- g) *The impact of COVID-19:* The impact of the COVID-19 pandemic can only be described as tragic. An estimated 5.85 million Americans have been infected, and over 180,000 Americans have lost their lives to this deadly virus. California has not been spared from this devastation. In this state alone, there have been 688,000 confirmed cases and 12,549 deaths. The pandemic has also battered this state's economy. According to the Employment Development Department, California's unemployment rate grew from 4% in June 2019, to a staggering 16.4% in May of this year, before coming down slightly to 14.9% in June. California's small businesses have been particularly hard hit. According

to the Facebook & Small Business Roundtable, roughly one-third had temporarily ceased operations nationwide by mid-April; and by the following month, more than one-half had laid off or furloughed employees. (*State of Small Business Report*, Facebook & Small Business Roundtable, May 2020.) McKinsey & Company, in turn, estimated that, before accounting for intervention, between 1.4 million and 2.1 million of these small businesses could close permanently as a result of the disruption experienced in just the first four months of the pandemic. (*Which Small Businesses are Most Vulnerable to COVID-19 – and When*, McKinsey & Company, June 18, 2020.)

- h) *Is this credit appropriately tailored to those most in need?* Given that this bill's credit appears primarily designed to confer relief on taxpayers struggling in the wake of the pandemic-induced economic crisis, it raises the question of whether this relief is appropriately tailored to help those most in need. This bill does require employers to have experienced a significant 50% decrease in year-over-year gross receipts. However, this bill provides the most generous credit amounts to those businesses that have been able, for whatever reason, to hire back their workforce during the five-month period beginning July 1, 2020. Thus, it could be argued that this bill confers the most generous benefits on those businesses that are well on their way to recovery, as opposed to those businesses currently unable to operate at anything comparable to a pre-pandemic normal. This credit is also not limited to those employer categories most impacted by the current crisis, such as the struggling restaurant industry. Additionally, this bill's definition of "small business" is rather expansive. Instead of defining a small business by reference to annual gross receipts, this bill defines a small business as one with 100 or fewer employees, apparently modeling the definition off of recent federal relief efforts. This could arguably confer benefits on businesses that are relatively large in terms of gross receipts but with a small employment footprint. Finally, because this bill provides the credit on a first-come, first-served basis, it is possible that this bill will primarily benefit relatively sophisticated businesses at the larger end of the small business range. These businesses often benefit from accounting and legal advice unavailable or underutilized by truly "mom and pop" operations.
- i) *Policy on tax expenditures:* Both R&TC Section 41 and Committee policy require any tax expenditure bill to outline specific goals, purposes, and objectives that the tax expenditure will achieve, along with detailed performance indicators for the Legislature to use when measuring whether the tax expenditure meets those stated goals, purposes, and objectives. A tax expenditure bill will not be eligible for a Committee vote unless it has complied with these requirements. This bill, in turn, complies with R&TC Section 41.

In addition to the R&TC Section 41 requirements, this Committee's policy also requires that all tax expenditure proposals contain an appropriate sunset provision to be eligible for a vote. According to the new policy, an "appropriate sunset provision" shall mean five years, except in the case of a tax expenditure measure providing relief to California veterans, in which case "appropriate sunset provision" shall mean ten years. This bill is only operative for one taxable year and, as such, complies with this Committee's sunset policy.

## REGISTERED SUPPORT / OPPOSITION:

**Support**

None on file

**Opposition**

None on file

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