SENATE COMMITTEE ON GOVERNANCE AND FINANCE

Senator Anna M. Caballero, Chair

2021 - 2022 Regular

Bill No:	SB 1349	**Hearing Date:**	3/31/22
Author:	Caballero	**Tax Levy:**	Yes
Version:	3/21/22	**Fiscal:**	Yes
Consultant:	Deitchman		

INCOME AND CORPORATION TAXES: CREDITS: WORK OPPORTUNITY CREDIT

Enacts a California Work Opportunity Credit for qualified employees.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives either to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something that but for the tax credit, they would otherwise not do. The Department of Finance is required annually to publish a list of state tax expenditures, currently totaling around $81.1 billion per year.

Work Opportunity Tax Credit. Enacted by Congress in 1994, the Internal Revenue Code allows employers to claim the Work Opportunity Tax Credit (WOTC) against federal income taxes based on a percentage of qualified wages paid to an individual who is a member of a targeted group. Federal law defines targeted groups as:

- Temporary Assistance to Needy Families (TANF) recipients;
- Veterans receiving Food Stamps, or those veterans with a service connected disability who:
    - Have a hiring date which is not more than one year after having been discharged or released from active duty, or
    - Have aggregate periods of unemployment during the one year period ending on the hiring date that equal or exceed six months.
- Ex-felons hired no later than one year after conviction or release from prison;
- Designated Community Residents, who are individuals between the ages of 18 and 40 on the hiring date who resides in a federal Empowerment Zone, or Rural Renewal County;
- Vocational rehabilitation referrals, including Ticket Holders with an individual work plan developed and implemented by an Employment Network;
- Summer youth ages 16 and 17 who reside in an Empowerment Zone;
- Food Stamp recipients between the ages of 18 and 40 on the hiring date;
- Supplemental Security Income (SSI) recipients;
- Long-term family assistance recipients;
- Long-Term unemployment recipients.

Employers in the state have two ways to obtain the certification necessary under federal law to claim the credit in California. First, the employer can obtain certification from the California Employment Development Department (EDD) that the individual is a member of a targeted group on or before the day the individual begins work. Second, the employer can complete a pre-screening notice on or before the day the individual is offered employment and submits such notice to EDD to request certification not later than 28 days after the individual begins work. Employers may not request certification on former employees who have been rehired; the employee can only be certified the first time they were hired by the employer.

California has never directly conformed to the WOTC. Instead, the state has allowed WOTC-eligible individuals to qualify employers for the now-defunct enterprise zone hiring credit.

The New Employment Credit. Under the new employment credit (NEC), taxpayers can claim credits against the Personal Income or Corporation Tax when they hire a qualified full-time individual on or after January 1, 2014. Qualified full-time employees include previously unemployed persons, veterans, ex-offenders, low-income families with children; work at least an average of 35 hours per week; and meet other specified requirements. To claim the credit taxpayers must:

- Pay qualified wages attributable to work performed by the qualified full-time employee in a designated geographic area;
- Receive a tentative credit reservation from the Franchise Tax Board (FTB) for that qualified full-time employee; and
- Certify each qualified employee annually.

State law sets the amount of credit at 35 percent of qualified wages, on wages between 150 percent and 350 percent of minimum wage, with the top and bottom wage range increasing over time due to increases in the minimum wage rate. However, taxpayers must have a net increase in its total number of full-time employees working in California when compared to its base year based on annual full-time equivalents to claim the credit. Additionally, to claim the credit, a qualified taxpayer must be:

- Engaged in a trade or business within a designated geographic area;
- Not engaged in any excluded businesses, including temporary help services, retail trades, those primarily in food services, alcoholic beverage places, theater companies, dinner theaters, casinos, and casino hotels unless the business is considered a small business; and
- Not engaged in a sexually-oriented business.

When the Legislature enacted the NEC in AB 93 and SB 90 as part of the budget in 2013, revenue estimates projected taxpayers would claim $22 million in NECs in the 2014 taxable year, and $69 million in the 2015 taxable year. However, final valid claims were $340,822 in 2014 (two percent of the initial estimate) and $693,323 in 2015 (one percent of the initial estimate). Over these first two tax years the credit was available, at least 1,829 taxpayers claimed the credit, but FTB determined that 83 percent of the claims were invalid. FTB reports that $3.3 million in NECs were generated for the 2018 tax year, $3 million has been generated for the 2019 tax year and $3.9 million in the 2020 tax year. The Legislative Analyst's Office states that these results suggest that the existing tax credit has been challenging or unappealing for businesses to use, and cites that the credits' high wage threshold, small credit amount, complexity, uncertainty, and interaction with other credits contribute to low participation. While Governor Brown proposed a California Hiring Credit to replace the NEC in his proposed 2018-19 Budget, the Legislature extended the NEC without substantive changes when it enacted the Budget (SB 855).

Arguing that the existing NEC is severely underutilized due to numerous limitations, the author wants to create a state WOTC to allow employers another opportunity to claim a hiring credit.

Proposed Law

Senate Bill 1349 allows a Work Opportunity tax credit against the Personal Income or Corporation Tax for qualified employers that hire qualified employees and pay wages subject to California withholding. The bill limits the credit to qualified employees who claimed a federal WOTC for the same employee in the same taxable year.

The bill limits the credit to the lesser of the amount of the federal WOTC claimed for the employee during the table year, or $1,000. The credit is available for the 2023 taxable year and before the 2026 taxable year.

The bill allows any unused credit to be carried over for up to three years, or until exhausted, whichever occurs first.

SB 1349 reduces the wage deduction otherwise allowed for qualified employees by the amount of credit claimed under this bill. Further, SB 1349 specifies that this credit must be taken in lieu of any other credit that the qualified taxpayer may otherwise claim for wages paid to a qualified employee.

SB 1349 is repealed on December 1, 2026.

State Revenue Impact

Pending.

Comments

1. Purpose of the bill. According to the author, "The Work Opportunity Tax Credit is a long-standing federal tax credit available to employers for hiring individuals from certain targeted groups of individuals who have consistently faced significant barriers to employment. The federal credit identifies ten groups of new hires, including Supplemental Nutrition Assistance Program (SNAP) and Temporary Assistance for Needy Families (TANF) recipients, as well as the long-term unemployed, disabled veterans, formerly incarcerated individuals, and other potential employees that need extra support and resources to enter the workforce. SB 1349 proposes to adopt a state tax credit for employers, using the same structure as the well-known federal Work Opportunity Tax Credit (WOTC). SB 1349 allows a $1,000 tax credit for employers to help increase workforce participation in WOTC program, and assists employers in managing significant wage inflation in the service sectors.

In 2020, CA certified 127,188 eligible employees for the federal credit. Of this total, nearly 54% were eligible through SNAP and nearly 11% were eligible through TANF. The Work Opportunity Tax Credit is more important now than ever, as many of California's most vulnerable individuals and families continue to struggle to recover financially as we all continue to deal with the COVID-19. Through WOTC, employers are incentivized to target jobs to these individuals to recruit and retain new employees, while receiving the benefit of the tax credit to help with increased labor costs in many of our service sectors. SB 1349 will serve as a new tax tool to help lift people out of poverty and provide paths to long-term employment."

2. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for taxpayers. Since the Legislature enacts these items to accomplish some governmental purpose, which has a cost — in the form of foregone revenues — state law refers to them as "tax expenditures." This bill would create a new tax credit that will cost the General Fund. Without General Fund moneys, the government has less funding to pay for important public services such as education and public safety. As a result, the state will have to reduce spending or increase taxes to match the foregone revenue. The Committee may wish to consider whether SB 1349 is worth the spending cuts and/or tax increases.

3. Effective? Tax benefits directed for specific purposes generally do two things. First, they reward behavior that would have occurred without the subsidy, providing a windfall benefit for firms who would've hired individuals with barriers to employment anyway. In these instances, the state receives no marginal benefit, and transfers funds from purposes it would otherwise spend money on for government purposes to the firm. Second, the bill may encourage some taxpayers to choose to hire an individual with a barrier to employment instead of an applicant without one, thereby providing the individual with employment, and potentially resulting in public savings from no longer having to provide public assistance to the individual. A successful tax benefit's gains exceed its losses, but no tax expenditure has yet conclusively demonstrated that its benefits outweigh its costs. Additionally, only those employees that get the federal WOTC are eligible. As a result, the credit will only be effective to the extent that an employer does not find the federal credit sufficient; instead, a state credit is also necessary to induce him or her to hire the individual with the barrier to employment instead of someone without one. The Committee may wish to consider SB 1349's effectiveness as a tool to boost employment for hard-to-hire individuals.

4. Assessing performance. The goal of the WOTC is not to create new jobs; instead, its purpose is to effectively subsidize employers to hire individuals from targeted groups with barriers to employment instead of others who do not face similar challenges. While few reviews of the WOTC exist, a 2011 paper from Peter Cappelli of the University of Pennsylvania's Wharton School of Economics indicates that existing evidence shows the federal WOTC's effect is positive for members of targeted groups, including a higher probability of obtaining employment, length of employment, wages, and tenure. Cappelli writes that while the targeted wage subsidies appear to be most effective, and the program itself is cost-effective, the increase in the probability of getting employed due to WOTC is relatively modest, among other findings. However, Cappelli does not assess the potential costs and benefits of a state WOTC counterpart, and states that employers who use the WOTC program have adjusted their hiring and employment practices for targeted individuals, which suggests that a state WOTC may reward behavior that is already taking place.

5. Technical. Committee staff recommends replacing the term "employer" with "qualified taxpayer" and "taxpayer" with "qualified taxpayer" for consistency of use. Additionally, to

ensure that definitions apply to the entire credit, the term "subdivision" should be replace with "section."

Support and Opposition(3/28/22)

Support: Asian, INC.
Automotive Service Councils of California
Beaumont Chamber of Commerce
Big Bear Chamber of Commerce
Build Out California
Burbank Chamber of Commerce
Cal Grocers Association
Calasian Chamber of Commerce
Calchamber
California Attractions and Parks Association
California Autobody Association
California Automotive Business Coalition
California Beer and Beverage Distributors
California Building Industry Association (CBIA)
California Business Roundtable
California Delivery Association
California Hispanic Chamber of Commerce
California Manufacturers and Technology Association
California Restaurant Association
California Retailers Associaiton
California Small Business Association
California Urban Partnership
California's Women's Business Centers
Cameo - California Association for Micro Enterprise Opportunity
Chino Valley Chamber of Commerce
Coalition of Small and Disabled Veteran Businesses
Corona Chamber of Commerce
Flasher Barricade Association
Fontana Chamber of Commerce
Greater Coachella Valley Chamber of Commerce
Greater High Desert Chamber of Commerce
Greater Ontario Business Council
Gusto
Hemet San Jacinto Valley Chamber of Commerce
Highland Area Chamber of Commerce
Inland Empire Economic Partnership (IEEP)
Menifee Valley Chamber of Commerce
Moreno Valley Chamber of Commerce
Murrieta Wildomar Chamber of Commerce
National Employment Opportunity Network
National Federation of Independent Business - California
Orange County Business Council
Perris Valley Chamber of Commerce
Rancho Cucamonga Chamber of Commerce
Redlands Chamber of Commerce
Sacramento Asian Pacific Chamber of Commerce
Sacramento Regional Builders Exchange (SRBX)
Slavic-american Chamber of Commerce
Small Business California
Small Business Majority
Temecula Valley Chamber of Commerce
United Chambers of Commerce
Upland Chamber of Commerce

Opposition: California Tax Reform Association

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