

Date of Hearing: April 20, 2010

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE  
ECONOMY

V. Manuel Perez, Chair

AB 2249 (Ruskin) – As Amended: April 13, 2010

SUBJECT: Disabled Veteran Business Enterprise: Tax Returns

SUMMARY: Requires the Department of General Services (DGS) to require a Disabled Veteran Business Enterprises (DVBEs) to file a completed form 4506-T from the federal Internal Revenue Service (IRS), also known as a Request for Transcript of Tax Return, in both of the following circumstances:

- 1) If DGS has received a complaint regarding the DVBE; or
- 2) If the DVBE is being audited by DGS.

EXISTING LAW:

- 1) Provides that DGS, except for contracts for certain professional bond services, is the administering agency of the California DVBE Program.
- 2) Sets an annual DVBE contract participation goal of 3% for each state department which awards contracts, including school districts, when expending certain state moneys for goods and services.
- 3) Requires state entities contracting for materials, supplies, equipment, alterations, or repairs to meet specified DVBE participation goals when submitting a bid for a state contract, including the requirement that the bid go to the lowest responsible bidder that meets the goal.
- 4) Defines "DVBE" as a business certified by the administering agency as meeting all of the following requirements:
  - a) It is a sole proprietorship at least 51 % owned by one or more disabled veterans or, in the case of a publicly owned business, at least 51 percent of its stock is owned by one or more disabled veterans; a subsidiary that is wholly owned by a parent corporation, but only if at least 51 % of the voting stock of the parent corporation is owned by one or more disabled veterans; or a joint venture in which at least 51 % of the joint venture's management, control, and earnings are held by one or more disabled veterans.
  - b) The management and control of the daily business operations are run by one or more disabled veteran. The disabled veterans who exercise management and control are not required to be the same disabled veterans as the owners of the business.
  - c) It is a sole proprietorship, corporation, or partnership with its home office located in the United States, and it is not a branch or subsidiary of a foreign corporation, foreign firm, or other foreign-based business.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Purpose: According to the author, this bill gives DGS an effective tool when determining the eligibility of a business for certification and recertification as a DBVE. The author has received a great deal of information that makes him suspect that some applicants are being certified when there are indications that they should not be, such as the applicant not being domiciled in California or the applicant for certification not being the true owner of certain equipment.

Even though DGS now requires DVBEs to file a copy of their income tax returns for the past three years, under penalty of perjury, as part of the application for certification, this bill gives DGS the ability to verify those tax returns by requiring a true copy of an applicant's federal income tax return through the use of federal Form 4506-T.

The April 13, 2010 amendments narrow the bill to require the use of federal Form 4506-T when there is a complaint lodged against a DBVE, or when there is an audit of an already certified DBVE.

- 2) DVBE Certification: Under the provisions of the DBVE program, each state agency is required, when awarding contracts throughout the year, to include DVBEs by taking all practical actions necessary to meet or exceed the annual 3% DVBE participation goal. In order to become a certified DVBE, the business must adhere to several requirements. For example, businesses must be owned, at a minimum of 51% by a disabled veteran, must be a California resident and the DVBEs home office must be located in the U.S., just to name a few.

As part of the DVBE certification process, DVBE businesses must re-apply for certification on a yearly basis. At the time of re-certification, the business must submit an application along with copies of the DVBE's income tax returns for the previous three years. The author contends that if complaints have been filed against the DVBE in the prior year, then a more stringent review should be required and the tax returns filed with the IRS should be part of that review.

- 3) Limited success in meeting state DVBE participation goals: The DVBE Program was established in 1989 to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices of Californians disabled during military service. Under the provisions of the program, each state agency is encouraged to honor California's disabled veterans by taking all practical actions necessary to meet or exceed the 3% DVBE state procurement participation goal.

However, success in meeting the 3% goal has been elusive. Even in 2007, when the state exceeded its 25% small business participation goal, the state only awarded 2.8% of its total contract dollars, \$186 million, to contracts involving DVBE contractors and subcontractors. Unfortunately, in 2008 DGS reported that the DVBE contract participation rate decreased to 2.39%.

California's progress in meeting this 3% goal has been further limited by a significant number of claims that DVBEs have been fraudulently added to contracts without any real intention that they would perform a commercially useful function and that too many bidders were fraudulently claiming to have made a good faith effort to hire a DVBE without taking meaningful action to offer the subcontract. While some progress has been made in tightening

the rules related to ensuring that DVBEs perform a commercially useful function, little progress had been made in strengthening the good faith effort provisions prior to their elimination on July 28, 2009 (AB 21, 4<sup>th</sup> Extraordinary Session, Chapter 19, Statutes of 2009).

- 4) California Small Business: California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$1.8 trillion economy. Businesses with fewer than 100 employees comprise nearly 98% of all businesses, and are responsible for employing more than 37% of all workers in the state.

As an example, small- and medium-sized businesses are crucial to the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy. Of the over 52,000 companies that exported goods from California in 2006, 95% were small- and medium-sized enterprises (SME) with fewer than 500 employees. These SMEs generated nearly half (44%) of California's exports in 2006. Nationally, SMEs generated only 29% of total exports.

Historically, small businesses have functioned as economic engines, especially in challenging economic times. During the nation's economic downturn from 1999 to 2003, microenterprises (businesses with less than five employees) created 318,183 new jobs or 77% of all employment growth, while larger businesses with more than 50 employees lost over 444,000 jobs. From 2000 to 2001, microenterprises created 62,731 jobs in the state, accounting for nearly 64% of all new employment growth. Unfortunately during the current recession, small business have been especially hard hit, with small business bankruptcies up 81% for the 12 months ending September 2009, as compared to the same period in the previous year. Nationally, bankruptcy filings were up 44%, according to Equifax Inc.

Because of their importance in the state economy, small business issues have been a particular focus of the Assembly Committee on Jobs, Economic Development and the Economy (JEDE) for the past several years. In March 2009, JEDE produced a state economic recovery strategy that included several key recommendations on the needs of small business, including helping small businesses meet their short term capital needs. In May 2009, JEDE held a special hearing to learn more about how the recession was impacting small businesses and in October, JEDE's review of the California Enterprise Zone Program included a panel on how the program responds to needs of small business.

The JEDE committee has previously passed legislation to increase enforcement of state procurement laws, AB 177 (Ruskin/VM Perez). AB 2249 furthers these actions by ensuring the credibility of an applicant's tax returns.

- 5) Related legislation: Related legislation includes the following:
  - a) AB 31 (Price) – Small Business Procurement Contracts: This bill made several key changes to state procurement procedures, including increasing the maximum contract threshold amount for awards to a small business or DVBE, under a specific streamlined procurement process, from \$100,000 to \$250,000. Further, the bill requires contractors that made contract commitments to include small business or DVBE participation to report the final percentage of the contract actually paid to these entities. Status: Signed by the Governor, Chapter 202, Statutes of 2009.

- b) AB 177 (Ruskin and V. Manuel Pérez) - Penalties under the Small Business Act: This bill increases and conforms penalties for persons who falsely engage in activities relating to the Small Business Procurement and Contract Act, including small businesses, microbusinesses, and disabled veteran-owned business enterprises. Status: The bill is pending in Senate Governmental Organization.
  - c) AB 309 (Price) – Small Business Participation: This bill requires the establishment of a 25% small business participation goal for all state entities and directs the Department of General Services (DGS) to monitor each agency's progress in meeting this goal. Status: Held on suspense in Assembly Appropriations Committee in 2009.
  - d) AB 2708 (Bill Berryhill) – Small Business Procurement: Prohibits the Department of General Services (DGS) and the directors of other state departments or agencies that enter into contracts from engaging in the bundling of contracts and other requirements as specified. Status: Pending in Assembly Jobs, Economic Development and the Economy Committee.
  - e) AB 2627 (Nielsen) – DVBE Contracts: This bill would deem a disabled veteran business enterprise that rents equipment to a contractor to be an equipment broker, would revise various related definitions pursuant to those provisions, including “broker” or “agent,” “equipment,” and “equipment broker. This bill also requires the broker’s commission fees of state funds expended through a broker or equipment broker to be credited toward the participation goals as DVBEs. Status: Pending in Assembly Jobs, Economic Development and the Economy Committee.
  - f) AB 2773 (Price) – Small Business Procurement Contract Act: This bill would have increased the maximum contract threshold amount for awards to small business, including microbusiness and DVBEs under the streamlined procurement process, from \$100,000 to \$250,000, as specified. Further, the bill required contractors that made contract commitments to include small business or DVBE participation to report the final percentage of the contract actually paid to these entities. Status: Held under submission in Senate Appropriations Committee in 2008.
- 6) Technical amendment: Currently there are three separate codes that include procurement laws. The author may wish to address how this measure integrates into the existing statutory requirement all three codes addressing DVBEs.

REGISTERED SUPPORT / OPPOSITION:

Support

None received

Opposition

None received

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