

# ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Maldonado Analyst: Roger Lackey Bill Number: AB 547

Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 02/21/2001

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Minimum Franchise Tax/Annual Tax Relief and Certification For Periods of Inactivity

## SUMMARY

This bill would

- provide that the minimum franchise tax and the annual tax would not be assessed in the year that a final return is filed, and
- permit certain suspended corporations to dissolve without requiring payment of certain tax liabilities.

## PURPOSE OF THE BILL

The Franchise Tax Board is sponsoring this bill to simplify the corporate dissolution and tax clearance process and to allow the taxpayer more time to complete the steps necessary to dissolve or cancel properly.

## EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective upon enactment and would be operative for taxable years beginning on or after January 1, 2001.

## POSITION

Support.

At its December 18, 2000, meeting, the Franchise Tax Board voted to sponsor the language introduced in this bill.

## ANALYSIS

### FEDERAL/STATE LAW

**Federal law** does not have a minimum franchise tax.

**Existing state law** provides that every corporation incorporated in this state, qualified to transact intrastate business in this state, or doing business in this state is subject to the minimum franchise tax. Liability for the minimum franchise tax begins on the earlier of the date of incorporation, qualification, or commencing to do business within this state. The yearly obligation to pay the franchise tax ends on the effective date of dissolution or withdrawal or, if later, the date the corporation ceases to do business within the state.

Board Position:

S       NA       NP  
 SA       O       NAR  
 N       OUA       PENDING

Department Director

Date

Alan Hunter for GHG

04/04/01

Further, **existing state law** provides that every limited partnership (LP), limited liability partnership (LLP), and limited liability company (LLC) not classified as a corporation that is organized in this state, qualified to transact intrastate business in this state, or doing business in this state is subject to an annual tax equal to the minimum franchise tax. Liability for the annual tax begins on the date of registration or qualification with the Secretary of State (SOS) or upon commencement of doing business within this State. The obligation to pay the annual tax ends on the effective date of the cancellation of the existence or qualification of the entity or the date the entity ceases to do business in the State.

**Existing state law** requires that a dissolving or withdrawing corporation subject to tax in this State must pay a tax for the year it ceases to do business in California. The amount of tax owed is measured by the corporation's net income for its final taxable year, but cannot be less than the minimum franchise tax.

**Existing state law** provides that prior to the dissolution of a corporation, the corporation must obtain a Tax Clearance Certificate from the Franchise Tax Board (FTB) certifying that its tax liabilities, if any, have been paid, assumed, or guaranteed by bond or otherwise.

For a corporation seeking dissolution, a Certificate of Dissolution and the request for a Tax Clearance Certificate are submitted to the SOS. The SOS files the Certificate of Dissolution and transmits the tax clearance documentation to FTB. FTB then either issues the Tax Clearance Certificate or notifies the requesting corporation of the amount of tax that must be paid, or the amount of bond, deposit, or other security that must be furnished as a condition of issuing the certificate. FTB notifies the SOS when all taxes have been paid or secured. The corporation is deemed dissolved on the date the original Certificate of Dissolution was filed. The dissolved corporation is no longer subject to the minimum franchise tax for taxable years beginning on or after the date of dissolution.

For a foreign corporation registered in California, liability for the minimum franchise tax continues until a Certificate of Surrender has been filed with the SOS. State law allows the SOS to issue a Certificate of Surrender of a foreign corporation only after FTB issues a Tax Clearance Certificate.

### THIS BILL

**This bill** would provide that the minimum franchise tax and the annual tax would not be assessed in the year that a final return is filed if two conditions are met:

- 1) the entity did not thereafter do business in California, and
- 2) dissolution, surrender, or cancellation of the entity is completed within 12 months of the due date of the tax return (without regard to extensions) for the final taxable year.

**This bill** would also permit certain suspended corporations to seek dissolution without payment of the accrued tax liability for years in which the corporation was inactive and not doing business.

## IMPLEMENTATION CONSIDERATIONS

To implement this bill, the department would need to determine whether a suspended corporation seeking dissolution meets the requirements of the bill for each year in question. As a result, the department would need assistance from the Employment Development Department (EDD) and the Board of Equalization (BOE).

This bill would require a publicity campaign or mass mailing to ensure that the affected entities are informed of the new law. Minor programming changes for the department's systems and additional training for staff would be necessary.

## **OTHER STATES' INFORMATION**

The states of Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York were reviewed for because the tax laws in those states have similarities to California's tax laws.

Each of these states has a different process for allowing business entities to dissolve, cancel, or withdraw. Generally, each of these states requires that the business entity resolve any tax obligations prior to the state recognizing the business entity dissolution, cancellation, or withdrawal.

The relief portion of this bill is unique to California taxpayers. Consequently, there is no relevant information from other states.

## **Legislative History**

SB 947 (Ch. 17 Stats. 1997) allowed the cancellation of tax for certain suspended banks and corporations that met specific criteria. The statute was repealed by its own provisions on January 1, 1999.

## **FISCAL IMPACT**

The department's business entities tax system (BETS) file indicates there are approximately 256,000 suspended entities. SOS records indicate a larger number (867,700). It is not known how many of these entities would seek the relief provided by this bill. Therefore, the actual impact upon the department's costs cannot accurately be determined at this time.

## **ECONOMIC IMPACT**

### Tax Revenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of AB 547 As introduced February 21, 2001 Effective 1/1/01 [\$ in Millions]			
	2001-02	2002-03	2003-02
No minimum tax in year of dissolution	(\$16)	(\$17)	(\$17)
Suspended entities that revive	(\$1)	(\$1)	(\$1)

For an entity that would otherwise forever remain on the department's records as suspended, this bill provides an opportunity to revive without paying any tax for the period of inactivity for purposes of dissolving. The cumulative tax savings for such entities could be on the order of \$600 million (assumes three-quarters of the 297,000 suspended entities discussed below are inactive and an average liability of \$2,700). The extent to which any of these entities would be induced to revive for purposes of dissolving or withdrawing is unknown. The probability of collecting any tax from such entities under current law is very low.

### Revenue Discussion

The revenue impact of this bill would be determined by (1) the number of businesses that would otherwise incur the minimum franchise or annual tax in the year the entity formally dissolves, and (2) the number of suspended entities that would otherwise revive and pay the minimum franchise or annual tax for the years suspended or inactive.

#### **No Minimum Tax in Year of Dissolution**

According to departmental data, corporations terminate at a rate of approximately 3.5% annually. The rate of corporate terminations is used as a proxy to determine the potential termination of other types of entities eligible under this proposal. In 2001, it is projected that nearly 20,000 entities will terminate.

#### **Suspended Entities that Revive to Dissolve**

Departmental staff that process reviver cases resolve roughly 3,000 each year. Of the 3,000 entities that revive, some 15% revive for purposes of dissolving. It is not known what amount of minimum franchise or annual tax, penalties, and interest is attributed to the 15% that revive for the sole purpose of dissolving. The majority of these taxpayers have been inactive for at least two years. Assuming an average period of inactivity of three years (or a liability of \$2,700 including penalties and interest), the projected loss is \$1.2 million annually [3,000 x 15% x \$2,700].

The extent to which any additional entities would be induced to revive for purposes of dissolving is unknown, although the number is likely to be insignificant. For a similar but somewhat more restrictive statute (Sec. 19432, which was repealed January 1, 1999), only a small number of corporations met the requirements and revived for purposes of dissolving.

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