

# ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Leach Analyst: Roger Lackey Bill Number: AB 898

Related Bills: See Legislative History Telephone: 845-3627 Amended Date: 05-01-2001

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

**SUBJECT:** Decrease Limited Liability Company Fees & Repeal Fee Adjustment

## SUMMARY

This bill would:

- Adjust the annual fee paid by limited liability companies (LLC) for the right to receive the benefits associated with organizing or registering as an LLC.
- Amend the meaning of "total income" for purpose of calculating the fee.
- Repeal the Franchise Tax Board (FTB) study of the LLC fee and authority to adjust the fee.

## SUMMARY OF AMENDMENTS

The May 1, 2001, amendments would adjust the LLC fee to \$11,790 for LLCs with total income of \$5,000,000 or more.

The bill as introduced February 24, 2001, is further discussed in "THIS BILL" below.

This is the department's first analysis of the bill.

## PURPOSE OF THE BILL

The author's staff indicated the intent of the bill is to reduce the annual fees paid by LLCs.

## EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would apply to taxable years beginning on or after January 1, 2001.

## POSITION

Pending.

Board Position:

\_\_\_\_\_ S                      \_\_\_\_\_ NA                      \_\_\_\_\_ NP  
\_\_\_\_\_ SA                      \_\_\_\_\_ O                      \_\_\_\_\_ NAR  
\_\_\_\_\_ N                      \_\_\_\_\_ OUA                      \_\_\_\_\_ X PENDING

Department Director

Date

Alan Hunter for GHG

05/03/01

**ANALYSIS**

FEDERAL/STATE LAW

Existing state law authorizes the creation of an LLC and the registration of LLCs created under the laws of other states.

Existing state law requires that for a business entity to receive the benefits associated with organizing or registering as an LLC in this state, the entity be required to pay both an annual tax and an annual fee.

Existing state law provides that every LLC not classified as a corporation that is organized in this state, registered in this state, or doing business in this state shall be subject to an annual tax. This annual tax will be an amount equal to the minimum franchise tax until the effective date of cancellation or, if later, the date the entity ceases to do business within the state.

Existing state law further provides that an LLC subject to the annual tax also shall pay an annual fee based on the total income from all sources reportable to this state for the taxable year. For example, for taxable years beginning on or after January 1, 1997, and before January 1, 1999, an LLC with total income for the taxable year greater than \$250,000, but less than \$500,000, was required to pay a fee equal to \$500. As the total income for the year increased, the fee increased to a maximum amount of \$4,500 based on a total income that exceeds \$5 million.

As required by state law, the FTB developed a report setting forth the methodology and assumptions used to determine the effect of recognizing LLCs on state tax revenues, which was submitted to the Joint Legislative Budget Committee in 1994. In 1999, the FTB began conducting an annual revenue estimate using the specified methodologies and assumptions set forth in the 1994 report. This estimate determines if state tax revenues have increased or decreased as a result of business entities organizing as LLCs in California rather than choosing other traditional forms of business organizations (e.g., corporations, partnerships, etc.). The state law requires that if the FTB estimate results in a net gain or reduction in state revenues because of the recognition of LLCs, the FTB is required, after a public hearing, to adjust the schedule of LLC fees to balance the revenue impact of LLCs.

The FTB conducted the study for the years 1999 and 2000. As a result, the fee was increased for 1999 and for 2000, as indicated in the chart below.

<u>Initial Fee</u>	<u>1999 Fees</u> <u>(Actual)</u>	<u>2000 Fees</u> <u>(Actual)</u>	<u>Total income</u>
\$ 500	\$ 865	\$1,042	\$250,000 or more, but less than \$500,000
\$1,500	\$2,595	\$3,126	\$500,000 or more, but less than \$1,000,000
\$3,000	\$5,190	\$6,251	\$1,000,000 or more, but less than \$5,000,000
\$4,500	\$7,785	\$9,377	\$5,000,000 or more.

## THIS BILL

This bill would fix the LLC fee amounts as follows:

- \$900 if total income is \$250,000 or more, but less than \$500,000
- \$2,500 if total income is \$500,000 or more, but less than \$1,000,000
- \$6,000 if total income is \$1,000,000 or more, but less than \$5,000,000
- \$11,790 if total income is \$5,000,000 or more

This bill would exclude from “total income” any income, gain, or distribution received by an LLC that was allocated or attributable to the LLC only as a result of being a member of another LLC. This exclusion would apply if the allocation or attribution of income or gain or distributions is directly or indirectly attributable to income used to determine the fee of another LLC.

This bill would eliminate the requirement that FTB prepare an annual study and estimate of the LLC fee. It also would repeal FTB’s requirement to make a subsequent adjustment of the fee based upon the findings of the annual study.

## IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department’s programs and operations.

## **LEGISLATIVE HISTORY**

AB 1970 (Leach, 1999/2000) would have repealed the state law requiring the FTB to conduct a study of the LLC fee and the subsequent adjustment of that fee upon certain findings. This bill died in Assembly Revenue and Taxation.

## **OTHER STATES’ INFORMATION**

The following states were chosen because their income tax system is similar to California’s.

*Florida:* No minimum franchise tax or other similar tax or fee for LLCs or any other type of business entity.

*Illinois:* LLCs treated as corporations pay an annual franchise tax based on paid in capital. The tax can range from a minimum of \$25 to a maximum of \$1 million.

*Massachusetts:* LLCs, like corporations, pay an excise tax equal to 9.5% of net income attributable to the state, and \$2.60 per \$1,000 upon the value of the taxpayer’s tangible property not subject to local taxation.

*Michigan:* LLCs as well as other business entities, pay a single business tax for the right to do business. The tax is 2.3% of the adjusted tax base.

*Minnesota:* Imposes an annual fee determined by property, payroll, and sales in the state. The fee can range from \$0 to \$5,000.

*New York:* Imposes an annual filing fee equal to \$50 multiplied by the number of members of the LLC, with a minimum fee of \$325 and a maximum fee of \$10,000.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### Tax Revenue Estimate

The revenue impact of this bill is projected to be revenue neutral for fiscal year 2001/02. Since the annual fee recalculation requirement in the future is repealed, minor net revenue gains or losses could result in any given future year. However, the more likely result over a span of years is revenue neutrality.

## **LEGISLATIVE STAFF CONTACT**

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