

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Wyland Analyst: Jeff Garnier Bill Number: AB 2328

Related Bills: See Prior Analysis Telephone: 845-5322 Amended Date: June 29, 2004

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: S Corporations/Built in Gains Tax /Conformity/ Accrual Method

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended May 13, 2004.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO No Position.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 1, 2004, STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would provide limited tax relief for corporations required in 2002 to be "S" corporations for state purposes. In addition, this bill would conform to the current federal accrual method of accounting rules.

SUMMARY OF AMENDMENTS

The June 29, 2004, amendments resolved one of the department's technical concerns. The provision relating to the federal "S" corporation election date had conflicting years in the statute. The amendments replaced "2003" with "2002" to make the operative date of the provision consistent with the stated operative date of the amendments. The amendments also made one other technical change. The June 29, 2004, amendments do not affect revenue.

For convenience, the "THIS BILL" section, the revenue table, and the remaining policy concerns of the prior analysis have been included below. Please see the April 1, 2004, analysis for background information about "S" corporations and the accrual method of accounting.

POSITION

No position.

Board Position:

_____ S _____ NA X NP
_____ SA _____ O _____ NAR
_____ N _____ OUA _____ PENDING

Legislative Director

Date

Brian Putler

7/14/04

THIS BILL

For "C" corporations required to be an "S" corporation for state purposes under the provisions of AB 1122 (Ch. 35, Stats. 2002), this bill would change, for purposes of determining the California Built In Gain (BIG) tax, the California "S" election date from the first day of the taxable year beginning in 2002 to the federal "S" election date. Because the provisions of AB 1122 apply to corporations that were federal "S" corporations prior to January of 2002, the federal election date will always be earlier than the first day the corporation became an "S" corporation for California. In the case of corporations that were federal "S" corporations prior to 1993, they will never be subject to the California BIG tax.

Under the Corporation Tax Law, this bill would conform state law to the Job Creation and Worker Assistance Act of 2002 federal law change with respect to the use of the accrual method of accounting. The federal law change further restricts the use of the cash method of accounting, thus requiring more taxpayers to use the accrual method of accounting.

ECONOMIC IMPACT

Revenue Estimate

Projected revenue losses are as follows (assumes enactment after 6/30/04):

Fiscal Year	2004-2005	2005-2006	2006-2007
Change of "S" Corporation Election Date Effect on the Built In Gain (BIG) Tax	Losses not exceeding \$1.5 million	Losses not exceeding \$500,000	Losses not exceeding \$500,000
Limitation of Non-Accrual Experience Method Accounting	Gains not exceeding \$4.5 million	Minor gains	Minor gains
TOTAL (order of magnitude)	\$3 million gain	Losses not exceeding \$500,000	Losses not exceeding \$500,000

POLICY CONCERNS

The bill would allow tax relief for some taxpayers and increase taxes for others for prior tax years. The bill fails to include a public purpose statement for retroactively reducing and increasing taxes.

The bill conforms to the federal treatment of the accrual method of accounting under the Corporation Tax Law, but neglects to conform under the Personal Income Tax Law. Thus, this bill would provide differing treatment based solely on classification, business type, or business organization.

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