Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

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

Related Bills: See Prior Analysis | Telephone: 845-5322 | Amended Date: 8/9, 17 & 23/ 2004

Attorney: Patrick Kusiak | Sponsor: ____________

SUBJECT: S Corporation Built-in Gains Tax Transitional Exclusion

_____ 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 introduced/amended ____________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ____________.

_____ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ____________. STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY

This bill would provide limited transitional tax relief for corporations that were required by 2002 legislation to be "S" corporations.

SUMMARY OF AMENDMENTS

The August 9, 2004, amendment resolved one of the two policy concerns identified in the prior analysis. The amendment added a public purpose statement for retroactively reducing and increasing taxes.

The August 17, 2004 amendments removed the provision conforming to the federal accrual method of accounting rules. For corporations required to be "S" corporations under AB 1122 (Stats. 2002, Ch. 35), the amendments also narrowed the relief from paying the built in gains (BIG) tax to those for property sold or under contract or option to sell property on or before the enactment date of AB 1122. A public purpose statement was also added resolving the department's remaining concern.

The August 23, 2004, amendments restored the bill to its August 9, 2004 version.

Due to new data, a revised revenue estimate is being provided in this analysis.

Except for remaining POLICY CONCERN and Economic Impact sections, the remainder of the analysis for the bill as amended June 29, 2004, still applies.

Board Position:			Legislative Director	Date
_____ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Jana Howard for Brian Putler	8/31/04
_____ N	_____ OUA	__X__ PENDING		

ECONOMIC IMPACT

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

Fiscal Year	2004-2005	2005-2006	2006-2007
Elimination of Built-in Gains (BIG) Tax	Losses not exceeding $4.5 million	Losses not exceeding $1.5 million	Losses not exceeding $1.5 million
Limitation of Non-Accrual Experience Method Accounting	Gain not exceeding $4.5 million	Minor gain	Minor gain
TOTALS (order of magnitude)	Unknown 1)	Losses not exceeding $1.5 million	Losses not exceeding $1.5 million

1) Insignificant loss or gain less than $150,000

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

<u>Tax Revenue Discussion:</u>

Revised Estimate for the Built-in Gains Tax

<u>The revenue estimate for this bill has significantly changed from the estimate contained in our analysis of the June 29, 2004, version due to the recent availability of corporation tax data for the 2002 tax year.</u> Based on the corporation tax model which now includes 2002 tax year data, it is estimated that the loss from the elimination of the BIG tax will be approximately $1.5 million annually. In the June 29, 2004 analysis for which 2002 data was not available, this loss was estimated at less than $500,000 annually.

For the 2002 tax year, corporations paid tax year $10 million in BIG tax. Of that S corporations that would qualify under provisions of this bill paid $2 million. The $2 million in BIG tax represents over $22 million in asset sales. The $2 million revenue loss from the elimination of the BIG tax will be offset by the shareholder tax on the $2 million and the 1.5% S corporation tax rate on the asset sales. The net impact is estimated to be $1.5 million annually.

Limitation on the Use of Non-Accrual Experience Method of Accounting

The estimate for conformity to the federal limitation on use of non-accrual experience method of accounting is based on federal projections for that provision. The 2004-05 impact for the state conformity includes the first two years of the federal projection since the provision would be effective January 1, 2003.

POLICY CONCERN

The bill would conform 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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