Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Firebaugh | Analyst: Kristina E. North | Bill Number: AB 678

Related Bills: None | Telephone: 845-6978 | Amended Date: April 22, 2003

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: New Corporations/Exempt From Tax & Fees Until Corporation Is In Existence For 3 years Or Grosses $500,000

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

_X_ 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 ________________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED FEBRUARY 19, 2003, STILL APPLIES.

_X_ OTHER - See comments below.

SUMMARY

This bill would exempt certain corporations from any corporate income or franchise taxes.

SUMMARY OF AMENDMENTS

The April 22, 2003, amendment replaces the bill's previous language and would exempt a corporation from corporate income or franchise taxes until the first of the following occurs:

- the corporation has been in existence for three years, or
- the corporation has $500,000 in annual gross receipts.

This bill specifies that the exemption would be effective upon the filing of articles of incorporation with the Secretary of State, or other appropriate office if a corporation is incorporated in other states or jurisdictions.

The April 22, 2003, amendment would resolve the implementation considerations in the department's analysis of the bill as introduced February 19, 2003. New implementation considerations are stated below. The remainder of the department's analysis of the bill as introduced February 19, 2003, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP	Brian Putler	04/28/03
____ SA	____ O	____ NAR		
____ N	____ OUA	_X_ PENDING		

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective and operative for taxable years beginning on or after January 1, 2003.

POSITION

Pending.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

- Under existing law, every corporation is required to pay estimated tax for the taxable year. These payments are made in four installments, but the amount of the first installment must be at least equal to the $800 minimum franchise tax (MFT). Since a corporation would not know its eligibility for the exemption proposed by this bill until the end of the year, it would be required to pay an amount equal to the MFT. Assuming a corporation was eligible for the proposed exemption, it would be entitled to a refund of the MFT.

- A corporation within a commonly controlled group might not have any gross receipts, however, the group itself could have substantial receipts that are far in excess of the $500,000 minimum threshold specified in this bill. The author may wish to consider adding language to clarify these matters.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Impact Assumed Enactment After June 30, 2003 ($ Millions)			
Fiscal Year	2003/04	2004/05	2005/06
Revenue Loss	-76	-45	-46

This analysis assumes an effective date with tax years beginning on or after January 1, 2003. This bill does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

This bill would impact the corporate franchise and income taxes paid to the Franchise Tax Board, i.e., the $800 MFT, and the measured corporate tax of 8.84% or 1.5%.

In the first fiscal year 2003/04, the impact is higher due to the doubling-up effect for calendar year filers with MFT payments due in April of each tax year. Doubling up means that there are two April 15 payments affected in the first fiscal year (2003/04). If this bill is enacted, MFT payments made in April of 2003 would have to be refunded and no MFT would be paid in April 2004 for the same taxpayer. Thus, the MFT payments that would have been paid for two tax years would have an impact in the first fiscal year.

The amount of franchise and MFT attributed to qualifying corporations under this bill is projected to be $43 million for the 2003 tax year (approximately 39,000 corporations). Roughly three-fourths of corporations are calendar filers, with the remainder being fiscal filers.

For 2003/04, the revenue impact from calendar filers is estimated to be -$32 million in 2003, and -$33 million in 2004. These amounts are added to the revenue impact from fiscal filers for 2003 of -$11 million, for a total 2003/04 impact of -$76 million. The revenue impact for 2004/05 is -$45 million, which is the sum of the 2005 impact for calendar filers of -$34 million and the 2004 impact for fiscal filers of $11 million. The revenue impact for 2005/06 is -$46 million, which is the sum of the 2006 impact for calendar filers of -$35 million and the 2005 impact for fiscal filers of -$11 million.

The revenue analysis for the bill as introduced February 19, 2003, was based on corporations with cumulative gross revenue not exceeding $500,000. The criterion of cumulative gross revenue greatly reduced the number of qualifying corporations. In addition, since the bill as introduced would have been effective for taxable years beginning on or after January 1, 2004, there was no doubling up effect in the first fiscal year.

POLICY CONCERN

Under this bill, a corporation having $499,999 in gross receipts, even if highly profitable, would pay no tax. However, a corporation having $1.00 more in gross receipts ($500,000), even if unprofitable, would be required to pay franchise or income taxes.

LEGISLATIVE STAFF CONTACT

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