

SUMMARY ANALYSIS OF AMENDED BILL

Author: Villines Analyst: John Pavalasky Bill Number: AB 2319
 Related Bills: See Prior Analysis Telephone: 845-4335 Amended Date: May 9, 2006
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Annual Tax or Minimum Franchise Tax is Zero for a Business's First Three Taxable Years/ Repeal Restriction on Refund of Limited Liability Company (LLC) Annual Tax Previously Paid

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced February 22, 2006.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS 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 February 22, 2006, STILL APPLIES.

OTHER – See comments below.

SUMMARY

This bill would, for new businesses having no income, waive the \$800 minimum tax for three years.

SUMMARY OF AMENDMENTS

The May 9, 2006, amendments to the provisions relating to the corporation minimum franchise tax as well as the annual tax on limited partnerships (LPs), limited liability partnerships (LLPs), and limited liability companies (LLCs) do the following:

- Make the minimum franchise tax and the annual tax equal to zero during any taxable year within the three taxable year period beginning with the taxable year the entity first became subject to tax under that section when that entity meets an income test.
- Expand the business entities eligible for the reduction in the minimum franchise tax and the annual tax under the bill to include those entities having losses and adds a return filing requirement.
- Modify the term "limited liability company" to mean "limited liability company that is classified as a partnership for California tax purposes" to be consistent with the return filing requirement.

Board Position:	Legislative Director	Date
_____ S		
_____ SA	Brian Putler	5/12/06
_____ N		
_____ NA		
_____ O		
_____ OUA		
_____ NP		
_____ NAR		
<input checked="" type="checkbox"/> PENDING		

The May 9, 2006, amendments impact revenue and a new revenue estimate is provided. Except for the revised discussion under THIS BILL and the revised ECONOMIC IMPACT, the remainder of the previous analysis of the bill as introduced February 22, 2006, still applies.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would replace the current law minimum franchise tax exemption for certain new corporations that currently only applies for the first taxable year, with a reduction in the \$800 minimum franchise tax to zero for any of its first three taxable years after becoming subject to the minimum franchise tax when that corporation meets a net income test. Under this bill, the minimum franchise tax reduction would only apply to corporations that incorporate or qualify to do business in this state on or after January 1, 2006, when the amount of the corporation's net income in that taxable year does not exceed zero. As under current law, that reduction expressly does not apply to those LPs, LLPs, and LLCs, which do not elect to be taxed as corporations under the "check-the-box" regulations, and RICs, REITs, REMICs, FASITs, and QSubs.

This bill would also reduce the annual tax (currently \$800) to zero for certain new LPs, LLPs, and those LLCs classified as partnerships for California tax purposes for any of that entity's first three taxable years after becoming subject to the annual tax when that entity meets an income test. Under this bill, the annual tax reduction would only apply to taxable years beginning on or after January 1, 2006, when the amount of that entity's ordinary income or loss from trade or business activities required to be shown on the tax return for that taxable year does not exceed zero. The reduction in annual tax provided by the bill would not apply to any LLC that is disregarded for tax purposes under the "check-the-box" regulations.

Additionally, this bill would repeal the provision that expressly prevents an LLC from receiving a reimbursement for any annual taxes or fees already paid, which was enacted in AB 1859 (Stats. 2004, Ch. 416) as part of the streamlining of the dissolution procedure for an LLC.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 2319 Effective On Or After January 1, 2006 Enactment Assumed After June 30, 2006 (\$ Millions)		
2005-06	2006-07	2007-08
-\$78	-\$140	-\$150

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue estimate for the bill as introduced counted only those companies with net income equal to zero in the first three years of existence. The number of companies in the first three years of existence and with net income equal to zero was 5,348. The number of companies was multiplied by \$800, the current amount of annual tax or minimum franchise tax, resulting in a revenue loss of over \$4 million (5,348 X \$800).

This bill as amended May 9, 2006, expanded the companies that would be eligible for the reduction in the annual tax or minimum franchise tax to include companies in the first three years of existence having losses as well as those with net income equal to zero. The number of such companies is 134,899. The number of companies was multiplied by \$800, the current amount of annual tax or minimum franchise tax, resulting in a revenue loss of over \$107 million (134,899 X \$800). The revenue loss for future years was increased by an annual growth rate of 10% to account for the increase in the number of companies that would qualify for this reduction. The resulting taxable year estimates were converted to the cash flow fiscal year estimates shown in the table. The first fiscal year 2005-06 is lower since it includes only the first half of 2006. The full impact the bill would occur in the second fiscal year, 2006-07.

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