Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Vargas	Analyst:	Norman Catelli	Bill Number:	AB 242
Related Bills:	See Legislative History	Telephone:	845-5117	Introduced Date:	February 7, 2005
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Limited Liability Underwritten Title Companies

SUMMARY

This bill would allow a limited liability company (LLC) to be licensed under the California Insurance Code as an underwritten title company (UTC).

This bill makes related changes to the Insurance Code relating to UTCs that do not impact this department and are not discussed in this analysis.

PURPOSE OF THE BILL

According to the author, the purpose of this bill is to allow UTCs the choice to operate as either a stock corporation or an LLC in California, which would eliminate the need to maintain multiple business structures in the various states.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative on January 1, 2006.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Under current state law, LLCs consist of one or more individuals, partnerships, limited partnerships, trusts, estates, associations, corporations, other LLCs, or other business entities. The LLC members are afforded limited liability similar to shareholders of a corporation.

Board Position:			Department Director	Date
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California tax law conforms to federal tax law regarding entity classification. An LLC is an “eligible business entity that may elect its tax classification. Generally, an LLC created in the United States with two or more members defaults to partnership classification. An LLC with one owner is “disregarded as an entity separate from its owner,” i.e., the LLCs income and deductions are reported on the owner’s tax return. All LLCs may elect to be taxed as corporations. LLCs not taxed as corporations are subject to an annual tax and a fee based on total income. Items of income, deductions, and credits are “passed through” and taxable to the owners, i.e., they are known as pass through entities.

LLCs are prohibited from engaging in the business of issuing policies of insurance and assuming insurance risks, or the trust company business.

“Underwritten title company” is currently defined in the Insurance Code as a domestic stock corporation engaged in the business of preparing title searches, title examinations, title reports, certificates, or abstracts of title upon the basis of which a title insurer writes title policies. The principle asset of a UTC is its “title plant.” A title plant is the collection and organization of property records used for title searches in the specific geographic area it serves.

The California Constitution authorizes the Legislature to impose taxes measured by income on all individuals and other entities (Article XIII, Section 26). The current tax rate applicable to the taxable income of a corporation, pursuant to the Corporation Tax Law, is 8.84%.

In lieu of a tax on income, the California Constitution provides for the taxation of insurers, including title insurance companies, based upon gross premiums (Article XIII, Section 28). The current tax rate applicable to the gross premiums of an insurer is 2.35%. The Constitution also extends the gross premiums tax to income derived directly or indirectly from the use of title plants by a title insurance company.

THIS BILL

This bill would allow a UTC to organize in California as an LLC.

IMPLEMENTATION CONSIDERATIONS

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

LEGISLATIVE HISTORY

AB 1962 (Cox, 2003-2004) was similar to this bill and would have allowed UTCs to be domestic LLCs. This bill was held in the Senate Judiciary Committee.

AB 2177 (Miller, Stats. 1996, Ch. 883) allowed insurance agents, brokers, or surplus line brokers to organize as LLCs.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

All the states surveyed allow title companies to organize as LLCs.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the revenue loss from this bill is as follows:

Estimated Revenue Impact of AB 242 Assume Effective January 1, 2006, With Enactment After June 30, 2005 ($ Millions)		
2005-06	2006-07	2007-08
-$8	-$23	-$26

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

Revenue Discussion

For purposes of this revenue estimate, it is assumed that all UTCs currently taxable as corporations would convert to LLCs and be owned by title insurance companies. Title insurance companies are exempt from the franchise or income tax, currently 8.84% of taxable income, but are subject to a gross premiums tax, currently 2.35% of gross premiums. Available information indicates that UTC income passed through to a title insurance company would be subject to the gross premiums tax.

To the extent that that a UTC does not convert to a noncorporate LLC or is not owned by an insurance company, the amount of the forecasted revenue loss would be reduced.

The revenue estimate was determined by multiplying estimated taxable income for all UTCs by the difference between the corporate tax rate and the gross premiums tax rate ($350 million x 8.84% minus 2.35%, or $31 million minus $8 million =$23 million).

The revenue estimate also does not reflect any tax revenue that may be attributable to the corporate dissolution requirements that the conversion of a corporation to a noncorporate LLC would require.

The estimates are based on actual tax return information for UTCs reported in combined reports representing 70% of the title insurance industry.

POLICY CONCERNS

If the following three conditions are met, the taxable income formerly taxable as an income tax at an 8.84% rate becomes taxable as a gross premiums tax at a rate of 2.35%:

- The UTC converts to the LLC business form,
- The LLC is treated as a pass through entity for tax purposes, and
- The LLC is owned by a title insurance company.

Tax laws should strive to be fair and equitable, with changes designed to create horizontal equity among similarly situated taxpayers. This bill would provide for different taxation of similar businesses based on business form.

LEGISLATIVE STAFF CONTACT

Norman Catelli
Franchise Tax Board
845-5117
Norm.Catelli@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
Brian.Putler@ftb.ca.gov