Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Garrick	Analyst:	Kristina E. North	Bill Number:	AB 1179
Related Bills:	See Legislative History	Telephone:	845-6978	Introduced Date:	February 23, 2007
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Minimum Franchise Tax /Change From $800 to $100

SUMMARY

This bill would reduce the minimum franchise tax (MFT).

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to: 1) encourage small businesses to comply with laws governing businesses, 2) make California more competitive with other states for business, and 3) reduce costs for businesses so they may reinvest in their business.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

STATE LAW

Under existing state law, unless specifically exempted by statute, every corporation organized or qualified to do business or that is doing business in this state (whether organized in state or out-of-state) is subject to the MFT. Taxpayers must pay the MFT only if it is more than their measured franchise tax. For taxable years beginning on or after January 1, 1997, only taxpayers with net income less than approximately $9,040 pay the MFT because the amount of measured tax owed would be less than $800 ($9,039 x 8.84% = $799).

Real estate mortgage investment conduits (REMICs) are subject to and required to pay the MFT. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations are also subject to and required to pay the MFT.

Board Position:			Department Director	Date
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The tax on limited partnerships (LPs), limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), and qualified Subchapter S subsidiaries (QSSSs) is set at $800 by reference to the MFT.

Every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, is exempt from the MFT for first taxable year of existence. This exemption is inapplicable to any corporation that reorganizes solely for the purpose of avoiding payment of the MFT. In addition, the exemption does not apply to LPs, LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, financial asset securitization investment trusts, and QSSSs.

THIS BILL

This bill would reduce the MFT from $800 to $100 for taxable years beginning on or after January 1, 2007. By reference to the MFT, the annual tax for the LPs, LLCs not classified as corporations, LLPs, and QSSSs would also be reduced to $100.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

LEGISLATIVE HISTORY

AB 1419 (Campbell, 1997/1998) would have reduced the MFT for a qualified corporation from $800 to $100. This bill failed passage from the Senate Revenue and Taxation Committee.

PROGRAM BACKGROUND

The MFT was established to ensure that all corporations pay at least a minimum amount of franchise tax for the privilege of doing business in this state, regardless of the corporation’s income (or loss).

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.

Florida does not have a minimum tax.

Illinois has a minimum tax based on paid in capital. The tax can range from a minimum of $25 to a maximum of $1 million.

Massachusetts has a minimum tax equal to $456.

Michigan has a Single Business Tax (SBT). The SBT does not have a minimum tax. All persons engaged in a "business activity" in Michigan are subject to the SBT. The tax is 1.9% of the adjusted tax base.

Minnesota has an additional minimum tax based on the sum of the property determined by property, payroll, and sales in the state. The tax can range from $0 to $5,000.

New York has a fixed dollar minimum tax based on gross payroll. The tax can range from $100 to $1,500.

FISCAL IMPACT

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

ECONOMIC IMPACT

Tax Revenue Estimate:

Based on data and assumptions discussed below, the Personal Income Tax and Corporation Tax revenue impact from this bill would be as follows:

Estimated Revenue Impact of AB 1179 Effective On Or After January 1, 2007 Enactment Assumed After June 30, 2007 ($ in Millions)			
2007/08	2008/09	2009/10	2010/11
-$630	-$635	-$585	-$645

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

Revenue Estimate Discussion

The revenue impact was first estimated separately for C and S corporations, LLCs, LPs, and LLPs and then totaled as follows:

C and S corporations must pay the larger of their income tax or the MFT. This revenue loss was estimated using a corporate microsimulation model based on the 2004 FTB corporate sample. For each corporation, the tax liabilities under the current and proposed laws were simulated, taking into account the corporation's taxable income, number of subsidiaries, and current and new minimum franchise taxes. The results from this simulation were expanded to the corporate population and extrapolated to later years. The extrapolation was based upon the latest Department of Finance forecast for corporate profits. For the 2008 tax year, the revenue impact of this bill for C and S corporations is estimated to be $360 million for 2007/2008.

LLCs must pay an annual tax that is the same amount as the MFT. The revenue loss for LLCs is estimated based on the expected number of LLCs times the $700 tax reduction. For the 2008 tax year, the expected number of LLCs is estimated at 257,100. It is assumed that the number of LLCs will grow at the rate of growth of corporate profits. For the 2008 tax year, the revenue impact of this bill for LLCs is estimated to be approximately $180 million (257,100 x 700 = $180M).

LPs and LLPs must pay an annual tax that is the same amount as the MFT. The estimated revenue impact for LPs and LLPs is product of the expected number of LPs and LLPs times the $700 tax reduction. For the 2008 tax year, the number of LPs and LLPs is estimated at 71,500. The number of limited partnerships and limited liability partnerships did not grow in recent years, and is assumed to stay constant in future years. For the 2008 tax year, the revenue impact of this bill for LPs and LLCs is estimated to be approximately $50 million (71,500 x $700 = $50M).

The estimated results for the 2004 tax year for the above business entities were totaled and extrapolated to the future years. For the 2008 tax year, the total impact of this bill is estimated to be a revenue loss of $590 million ($360M + $180M + $50M = $590M). The tax year estimates are converted to fiscal year revenue estimates reflected in the above table. For example, the 2007/08 cash flow estimate of a revenue loss of $630 million consists of a $200 million loss for tax year 2007, plus $430 million loss for tax year 2008 due to tax refunds and reduced estimated tax payments.

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