

REVISED ANALYSIS

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

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

- REVENUE ESTIMATE CHANGED.
 FURTHER CONCERNS IDENTIFIED.
 REMAINDER OF PREVIOUS ANALYSIS OF THIS BILL AS INTRODUCED
 FEBRUARY 23, 2007, STILL APPLIES.
 OTHER – See comments below.

SUMMARY OF BILL

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

SUMMARY OF REVISION

The revenue estimate contained in the department's analysis of the bill as introduced February 23, 2007, has been revised to correct the method used to convert from taxable year estimates to cash flow fiscal year estimates. Additionally, an explanation of the 2009/10 reduced revenue impact has been added. The remainder of the department's analysis of this bill as introduced February 23, 2007, still applies.

Board Position:

_____ S _____ NA _____ NP
 _____ SA _____ O _____ NAR
 _____ N _____ OUA PENDING

Legislative Director

Date

Brian Putler

5/2/07

ECONOMIC IMPACT

Original Revenue Estimate

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

Revised Revenue Estimate

The revised figures in the table below are emphasized in bold font for ease of reading.

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	-\$590	-\$620

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

Explanation of the 2009/2010 Reduced Revenue Impact

The revenue loss would be less in 2009/2010 compared to the first two years due to a variety of factors. This bill would be effective for taxable years beginning on or after January 1, 2007. It is expected that this bill would be enacted during the 2007/2008 fiscal year. As such, for the 2007 taxable year most corporations would have already paid their first quarterly estimated tax payment, which would include the MFT of \$800. Any overpayments due to the reduction of the MFT would impact the revenue after returns are filed for the 2007 taxable year. It is expected that these returns would be filed and overpayments would be issued during the 2007/2008 and 2008/2009 fiscal years, resulting in a larger revenue loss in those years.

The 2009/2010 fiscal year revenue loss would be affected by the 2008 taxable year and is expected to be less than the first two fiscal years. It is expected that first quarter estimated tax payments would be reduced to reflect the MFT of \$100, and compared to the 2007 taxable year would not result in many overpayments related to the reduced MFT. As such, the revenue impact would be reduced for the 2009/2010 and 2010/2011 fiscal years.

Revenue Discussion

The revenue impact was first estimated separately for C and S corporations, limited liability companies (LLCs), limited partnerships (LPs), and limited liability partnerships (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 Franchise Tax Board (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 ($257,100 \times \$700 = \$180M$).

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 the 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 ($71,500 \times \$700 = \$50M$).

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.

LEGISLATIVE STAFF CONTACT

Kristina E. North
Franchise Tax Board
(916) 845-6978
Kristina.North@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
Brian.Putler@ftb.ca.gov