

SUMMARY ANALYSIS OF AMENDED BILL

Author: Calderon Analyst: Gail Hall Bill Number: AB 1546
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: May 3, 2007
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Limited Liability Company Fee

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

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 _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED

February 23, 2007, STILL APPLIES.

OTHER – See comments below.

SUMMARY

This bill would apply certain rules used to determine the income of entities doing business within and outside the state to the calculation of the Limited Liability Company (LLC) fee.

SUMMARY OF AMENDMENTS

The May 4, 2007, amendments made the following changes to the bill:

1. Deleted “reportable” to the state and substituted “derived from or attributable” to the state.
2. Removed the provisions that would have provided a definition in the statute for “total income from all sources reportable to the state” to mean total income after applying the apportionment and allocation rules.
3. Added a provision that would determine total income from all sources derived from or attributable to this state by utilizing the rules in current law for assigning California sales for purposes of computing the numerator of the sales factor for apportioning entities.

Board Position:	Legislative Director	Date
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Except for the FEDERAL/STATE LAW, THIS BILL, AND ECONOMIC IMPACT sections discussed in this analysis, the remainder of the department's analysis of the bill as introduced on February 23, 2007, still applies. The TECHNICAL CONSIDERATIONS section of the analysis of the bill as introduced on February 23, 2007, is provided for convenience purposes.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Federal law lacks provisions that require any LLC to pay an annual tax or fee.

Under current state law, an LLC not classified as a corporation must pay the \$800 annual LLC tax and the annual LLC fee if it is organized, doing business, or registered in California. The annual LLC fee is based on the LLC's total income from all sources reportable to the state. Total income is defined as gross income from whatever source derived¹ plus the cost of goods sold that are paid or incurred in connection with a trade or business. Current law lacks a definition for "from all sources reportable to the state," but the department has interpreted this term to mean worldwide total income without apportionment. Total income excludes the flow-through of total income from one LLC to another LLC if that income has already been used to determine the annual LLC fee of an LLC. The following chart is used to determine the amount of the fee:

[---If Total Income From All Sources Reportable To This State Is---]

Equal To Or Over (\$)	But Not Over (\$)	LLC Fee (\$)
250,000	499,999	900
500,000	999,999	2,500
1,000,000	4,999,999	6,000
5,000,000	And over	11,790

California has adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), with certain modifications, to determine how much of a taxpayer's total income, which is earned from activities both inside and outside of California, is attributed to California and subject to California franchise or income tax. An apportionment formula is used to determine the amount of "business"² income attributable to California. The apportionment formula consists of property, payroll, and sales factors.

The sales factor is determined by dividing total sales in California by total sales worldwide during the taxable year.

¹ Revenue & Taxation Code (R&TC) Section 24271 and Internal Revenue Code (IRC) Section 61.

² R&TC Section 25120(a) defines business income as income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

The following is a list of the general rules utilized to determine California sales for the sales factor calculation:

- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser in this state, and the taxpayer (seller) is taxable in this state.
- Sales of tangible personal property are assigned to California if the product is delivered or shipped to a purchaser out of state, and the taxpayer (seller) is not taxable in the state of destination.
- Sales of tangible personal property to the U.S. Government are assigned to California if the goods were shipped from California.
- Sales from the performance of personal services are assigned to California if the services were performed in California. If personal services were performed in more than one state, then the receipts from the services would be assigned to California based on the ratio of time spent performing such services in the state to total time spent in performing such services everywhere.
- Sales from intangibles and all other services are assigned to California if the income producing activity that gave rise to the receipts is performed wholly within California. If the income producing activity is performed within and outside the state, then the sales from intangibles and all other services, are assigned to California if the greater cost of performance of the income producing activity is performed in this state.
- Sales from the sale, rental, lease, or licensing of real property and the receipts derived from the rental, lease, or licensing of tangible personal property are assigned to California if the property is located in California.

There are additional rules for assigning sales to California for sales factor purposes, including special rules established in regulations issued under California Revenue and Taxation Code section 25137³ for cases where the general rules for assigning sales to California would unfairly represent the taxpayer's business activities within the state.

THIS BILL

This bill would determine an LLC's fee based on the LLC's total income derived from or attributable to the state. The level of activity would be determined by applying the current law's franchise/income tax sales factor rules to the total income of the LLC (as defined in the bill) in order to calculate the amount of income derived from or attributable to the state.

TECHNICAL CONSIDERATIONS

The public purpose statement in the Legislature's findings and declarations is unnecessary because there is no retroactive provision in this bill, and therefore, no gift of public funds. The author should consider deleting subdivision (c) in Section 1.

³ California Code of Regulations (CCR), title 18, section 25137.

ECONOMIC IMPACT

Revenue Estimate

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

Estimated Revenue Impact of AB 1546 Enactment Assumed After June 30 Accrual Basis (\$ in Millions)			
2006/07	2007/08	2008/09	2009/10
\$0	- \$40	- \$45	- \$50

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

Revenue Discussion

Under this bill, LLC fees would be determined based on assigned total income to California rather than worldwide total income. In 2004, there were \$246 million in LLC fees collected from 164,206 LLC returns. LLC fees are projected to grow to \$415 million in 2009.

This estimate is based on a representative sample of more than 1,800 LLC returns from 2004. A subset of more than 500 LLC returns reported sales factor information. For each LLC return in the subset, the LLC fee was first calculated using current law's worldwide total income. Second, the LLC fee was calculated using the proposed bill's assigned total income to California. The results were compared and based on the testing, it was determined that this bill would have decreased the amount of fees collected by just over 12%. The 12% was applied to the 2004 total LLC fees collected, and it was estimated that this bill would have decreased the amount of fees received in 2004 by 12%, or \$30 million (12% x \$246 million). The \$30 million was grown to subsequent years and converted to fiscal years.

Although the May 4, 2007, amendments replaced the method LLCs would use to determine total income assigned to California from utilizing an apportionment formula to utilizing current law's rules for computing the numerator of the sales factor, the revenue impact stayed the same. One reason the revenue impact stayed the same was due to rounding. The revenue estimate of the provisions of the bill as introduced February 23, 2007, would have resulted in a decrease of just **under** 12% in the amount of LLC fees collected versus the revenue estimate discussed in this analysis would result in a decrease of just **over** 12% in the amount of LLC fees collected. In addition, an LLC's fee is determined using a tiered chart, which means that although the method utilized to determine an LLC's total income assigned to California changed and resulted in a different amount of total income assigned to California, when applying the tiered chart, the LLC fee remained the same.

The existing structure of LLC fees is being challenged in court. The estimate above is based on the assumption that the fees will ultimately be upheld. Should the courts reject the fees entirely, and no legislative alternative such as this bill is adopted, the potential revenue loss is estimated to be about \$1.3 billion for open tax years plus an ongoing cost that reaches over \$400 million per year by 2009/10. AB 1546 does not address the potential loss of \$1.3 billion. It does reduce the potential ongoing revenue loss from about \$400 million to about \$50 million (for the 2009/10 fiscal year).

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