Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Calderon   Analyst: Gail Hall   Bill Number: AB 1546

Related Bills: See Prior Analysis   Telephone: 845-6111   Amended Date: September 5, 2007

Attorney: Patrick Kusiak   Sponsor: ______

SUBJECT: Limited Liability Company Fee/Remedy For Final Court Decisions

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

_X_ 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 ________.

_X_ REMAINDER OF PREVIOUS ANALYSES OF BILL AS INTRODUCED/AMENDED February 23, 2007, May 3, 2007, and May 9, 2007, STILL APPLY.

_X_ OTHER – See comments below.

SUMMARY

This bill would do the following:

- apply the rules for assigning the income of entities doing business within and outside the state to the calculation of the Limited Liability Company (LLC) fee, and
- provide a rule for determining a remedy for final court decisions that hold a statute unconstitutional.

SUMMARY OF AMENDMENTS

The September 5, 2007, amendments made the following changes to the bill:

- Added a statutory remedy for final court decisions where a statute is held unconstitutional by codifying the recent decision of the California Court of Appeal in *Macy's Department Stores, Inc.* v. *City and County of San Francisco* (2006) 143 Cal.App.4th 1444.
- Added no inference language and a specified operative date.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	9/07/07
____ N	____ OUA	_X_ PENDING		

Except for the “Effective/Operative Date,” “Background,” “This Bill,” and “Economic Impact” discussions, the remainder of the department’s analyses of the bill as introduced on February 23, 2007, and amended on May 3 and May 9, 2007, still apply. The technical consideration discussed in the previous analyses no longer applies.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The new rule for determining total income derived from or attributable to California would specifically be operative for taxable years beginning on or after January 1, 2007, and contains a "no inference" clause with respect to taxable years beginning before January 1, 2007. The new rule for calculating a taxpayer’s remedy after a statute is held to be discriminatory or results in unfair apportionment would specifically apply to suits not yet final and to all future suits for refund.

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would amend current law to do the following:

1. 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.
2. Provide that any personal income taxpayers or corporate franchise/income taxpayers that file claims for refund asserting that a fee, tax, deduction, credit, or exclusion is discriminatory or unfairly apportioned in violation of the California Constitution or the laws or Constitution of the United States would have the amount of their claim for refund recalculated in an amount necessary to remedy the discrimination or unfair apportionment required by the statute.
3. Specify that any claims for refund filed by LLCs as a result of pending litigation challenging the validity of the LLC fee would be limited to the amount of the LLC fee paid, plus any interest assessed, that exceeds the amount of LLC fee that would have been paid had this bill’s new rule for determining the LLC’s total income derived from or attributable to the state been applied.

BACKGROUND

The following discussion supplements the Background section of the analysis of the bill as introduced February 23, 2007, by including new litigation relating to the constitutionality of the LLC fee for an LLC with income derived solely from within California.

Bakersfield Mall, LLC v. Franchise Tax Board, Case No. 462728, is currently before the San Francisco Superior Court. The Plaintiff is an LLC that registered with the California Secretary of State and alleges its income was derived solely within California. The Plaintiff claims that the LLC fee is an unapportioned tax that violates the Commerce Clause of the United States Constitution and the Due Process Clauses and the Equal Protection Clauses of the California and United States Constitutions.

FISCAL IMPACT

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

ECONOMIC IMPACT

The September 5, 2007, amendments are a codification of the recent decision of the California Court of Appeal in *Macy's Department Stores, Inc. v. City and County of San Francisco* which held that Due Process only required the city to refund the amount that was necessary to alleviate the amount of tax that was found to be improper in that case. The United States Supreme Court denied the taxpayer's Petition for Certiorari on June 25, 2007. As such the amendments of September 5, 2007 have no impact on revenue.

The "Economic Impact" discussion in the department's analysis of the bill as amended May 3, 2007, still applies, but is provided below for convenience.

<u>Revenue Estimate</u>

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 3, 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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