Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Garrick	Analyst:	Angela Raygoza	Bill Number:	AB 2178
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	February 20, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Reduce The Minimum Franchise Tax from $800 to $200/Technical Changes

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 do the following: (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 operative for taxable years beginning on or after January 1, 2008.

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 with less than 15 calendars days in a taxable year are not required to pay 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 C corporation 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).

Board Position:			Department Director	Date
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Real estate mortgage investment conduits (REMICs) and financial asset securitization investment trusts (FASITs) 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.

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 the first taxable year of existence. This exemption is inapplicable to any corporation that reorganizes solely for the purpose of avoiding payment of the MFT. The exemption does not apply to LPs, LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, FASITs, or QSSSs.

<u>THIS BILL</u>

This bill would reduce the MFT from $800 to $200 for taxable years beginning on or after January 1, 2008. This bill would apply to corporations, LPs, LLCs not classified as corporations, LLPs, and QSSSs as well as charitable organizations, RICs, REITs, REMICs, and FASITs.

This bill would also delete expired provisions within section 23153 of the Revenue and Taxation Code.

<u>IMPLEMENTATION CONSIDERATIONS</u>

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 1179 (Garrick, 2007/2008) was similar to this bill except the MFT for a qualified corporation would have been reduced from $800 to $100. This bill failed passage in the Assembly Revenue and Taxation Committee.

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.

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 $25 to $1 million.

Massachusetts has a minimum tax equal to $456.

Michigan has the Michigan Business Tax (MBT). Beginning January 1, 2008, Michigan taxpayers are subject to the Michigan Business Tax. The MBT is composed of two taxes, a business income tax of 4.9% on every taxpayer with business activity in the state and a modified gross receipts tax of 0.80% on every taxpayer having nexus with Michigan. Taxpayers with gross receipts of less than $350,000 are not required to file a return or pay the MBT.

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

Revenue Estimate

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 2178 Effective for Tax Years BOA January 1, 2008 Enactment Assumed after June 1, 2008 ($ in Millions)		
2008/09	2009/10	2010/11
-$675	-$429	-$489

Revenue Discussion

The revenue impact of this bill would be determined by the reduction in minimum tax from $800 to $200. The revenue loss is estimated separately for C and S corporations, LLCs, LPs, and LLPs.

First, the revenue loss due to C and S corporations, including banks and financial corporations, is estimated using a department model that uses 2005 corporate tax return sample data. For each corporation, 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 corporation must pay the larger of the computed income tax or the minimum franchise tax. The results from this simulation were expanded to the corporate population (651,059 in 2005). The estimated revenue loss would be $277 million for the 2005 tax year.

Second, because LLCs, LPs, and LLPs are not subject to the corporate income tax, and instead pay the minimum franchise tax, the revenue loss attributable to these business entities is estimated by multiplying the number of those entities by the amount of the tax reduction $600 ($800 - $200). The revenue losses for the 2005 tax year are approximately $98 million for LLCs (164,096 x $600), $37 million for LPs (62,446 x $600) and $3 million for LLPs (4,578 x $600).

Finally, the estimated revenue losses for tax year 2005 for C and S corporations, LLCs, LPs, and LLPs are added ($277+ $98 + $37 + $3 = $415 million) and extrapolated to future years using corporate profits growth rate. Using corporate profits growth rates, the revenue losses are $477 million for tax year 2008 and $496 million for tax year 2009. These figures are converted to fiscal year estimates in the table above.

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