

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Migden Analyst: Gail Hall Bill Number: SB 105
Related Bills: See Legislative History Telephone: 845-6111 Amended Date: March 19, 2007
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Registered Domestic Partnerships/Tax Treatment Same As Married Couple Except If Classification of Business Entity Would Be Different Than Federal.

SUMMARY

This bill would clarify the definition of a spouse for income tax purposes.

SUMMARY OF AMENDMENTS

The March 19, 2007, amendments clarify that a Registered Domestic Partner (RDP) will be treated as a spouse or former spouse with one exception. (See the This Bill section of the analysis for further discussion).

PURPOSE OF THE BILL

The author's staff has indicated the purpose of the bill is to clarify and resolve issues relating to SB 1827 (Stats. 2006, Ch. 802), which enacted the requirement that RDPs use the same filing status as married persons, to ensure an effective implementation of the enacted law.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately and apply to taxable years beginning on or after January 1, 2007.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal law treats registered domestic partners (RDPs) as single individuals instead of spouses that are married or members of the same family.

Board Position:

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Department Director

Date

Selvi Stanislaus
by Lynette Iwafuchi

4/19/07

An S Corporation is a form of a corporation that enables the company to enjoy the benefits of incorporation but is taxed similar to a pass-through entity (i.e. partnership). A corporation may elect to be treated as an S Corporation if certain requirements are met. One of those requirements is that the S Corporation's total shareholders must be less than or equal to 100. Spouses and all members of a family are treated as one shareholder.

Current state law requires RDPs to file a personal income tax return jointly or separately by applying the standards applicable to married couples under federal income tax law. RDPs are treated as spouses for state income tax purposes.

A corporation may qualify as an S corporation under California law only if it has a valid federal S corporation election in effect. In other words, the federal S corporation requirements must also be met for California purposes. There is no independent California election allowed that would permit a federal S corporation to elect to be taxed as a regular corporation for California purposes. Similarly, current law does not allow a corporation to be an S corporation only for California purposes.

In meeting the less than or equal to 100 shareholder S corporation requirement, RDPs will be treated as one shareholder for state purposes versus two shareholders for federal purposes. This could result in a corporation that was not eligible to be an S corporation for federal purposes to be an S corporation for California purposes. Similar issues arise in connection with the classification of business entities based on whether the entity is owned by one person or by more than one person.

THIS BILL

This bill would accomplish the following:

- Clarify that an RDP or former RDP would be treated as a spouse or former spouse for personal income tax and corporation tax purposes.
- Provide an exception to treating RDPs as spouses for business entity classifications to avoid having an entity classified differently for state purposes than for federal purposes. For example, this exception would avoid an S corporation meeting the 100 shareholder requirement for state purposes and not for federal purposes because there were two RDP shareholders that for federal purposes put the total amount to 101 shareholders, disqualifying the S corporation status.

LEGISLATIVE HISTORY

SB 1827 (Migden, Stats. 2006, Ch. 802) requires RDPs to file as either married filing joint or married filing separate for state income tax purposes for taxable years beginning on or after January 1, 2007.

AB 205 (Goldberg, Stats. 2003, Ch. 421) as introduced on January 28, 2003, would have allowed domestic partners to file personal income tax returns as either: (1) married filing joint, or (2) married filing separate. The bill as chaptered made changes to various California laws regarding domestic partners, including the creation of community property rights. It also added language that required the same filing status on a state income tax return as used on the federal income tax return and provided that earned income is not community property for state income tax purposes. The August 18, 2003, amendments to the bill removed the provisions of the bill that would have allowed domestic partners to file personal income tax returns as either: (1) married filing joint, or (2) married filing separate.

OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. The laws of these states were reviewed because their tax laws are similar to California's income tax laws. Only *Massachusetts* allows domestic partners to file tax returns as married filing joint or married filing separate.

For tax periods ending on or after May 16, 2004, *Massachusetts* recognizes the right of same-sex couples to be married. As a consequence, same-sex spouses that marry shall file *Massachusetts's* income tax returns as married filing joint or married filing separate.

Massachusetts is not a community property state. Research found no provisions relating to how *Massachusetts's* law handles the state/federal difference of treating RDPs as one shareholder or two shareholders.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 105 Operative For Taxable Years Beginning On Or After January 1, 2007 Enactment Assumed After June 30, 2007 (\$ in Millions)			
	2006-07	2007-08	2008-09
Income Tax Loss	0	0	0

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

Revenue Discussion

The amendment providing that RDPs would be treated as spouses or former spouses is declaratory of existing law and would have no impact on state income tax revenue.

There could be circumstances under which a particular business entity classification type would be allowed under state law but not under federal law (e.g., an S-corporation that would exceed the limit on the number of owners if RDPs were counted separately, but not if they are counted jointly). The department is unaware of any specific entities that would be classified differently for state purposes because shareholders are RDPs. This estimate assumes that taxpayers generally follow federal law when choosing an entity type because federal law is more restrictive with respect to entity types. It is anticipated that businesses will not suffer adverse consequences from entity reclassifications under current state law. Therefore, this bill would have no revenue impact.

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