

**SUMMARY ANALYSIS OF AMENDED BILL**

Author: Cook Analyst: Gail Hall Bill Number: AB 2671  
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: April 27, 2010  
 Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Minimum Franchise Tax/Exempt Corporations And Limited Liability Companies Owned Solely By Deployed Member Of U.S. Armed Forces That Operate At A Loss Or Ceases Operation

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 DEPARTMENTS 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 19, 2010, STILL APPLIES.

OTHER – See comments below.

**SUMMARY**

This bill would exempt certain corporations and limited liability companies (LLC) owned solely by a deployed member of the U.S. Armed Forces from the \$800 annual tax or minimum franchise tax.

**SUMMARY OF AMENDMENTS**

The April 27, 2010, amendments made the following changes to the bill:

- Addressed the implementation concern discussed in the department's analysis of the bill as introduced February 19, 2010, by amending the bill to apply to LLCs and revising the definition of deployed. (Appendix A)
- Limited the provisions of the bill to small businesses.
- Added that the Franchise Tax Board (FTB) shall promulgate certain regulations.
- Added that the Legislative Analyst Office (LAO) would issue a report to the Legislature.

Board Position:	Legislative Director	Date
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<input checked="" type="checkbox"/> PENDING	Brian Putler	05/11/10

- Added that the Assembly Committee on Revenue and Taxation would hold an informational hearing.
- Revised the operative date.
- Resulted in two additional implementation and technical concerns.

Except for the “Effective/Operative Date,” “Implementation Concerns,” “Technical Concerns,” and “Economic Impact” discussions, the remainder of the department’s analysis of the bill as introduced on February 19, 2010, still applies.

### **EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately and would apply to taxable years beginning on or after January 1, 2010, and would be specifically inoperative on January 1, 2018.

### **POSITION**

Pending.

### **ANALYSIS**

#### THIS BILL

This bill would allow either a corporation or an LLC that is a small business with a sole owner who is a member of the U.S. Armed Forces to be exempt from paying the \$800 minimum franchise tax for any taxable year if both of the following apply:

- The owner is deployed during that taxable year, and
- The corporation or LLC operates at a loss or ceases operation in that taxable year.

The Franchise Tax Board would be required to promulgate regulations to provide for a definition of “ceases operations.”

In addition, this bill would require on or before January 1, 2018, the LAO to review and report to the Legislature on the effectiveness of the exemption provided by this bill. After the LAO issues the report, the Assembly Committee on Revenue and Taxation would hold an informational hearing on the effectiveness of the exemption provided by this bill.

This bill would define the following terms:

- “Deployed” would mean being called to active duty or active service during a period when a Presidential Executive order specifies that the U.S. is engaged in combat or homeland defense. “Deployed” would specifically exclude temporary duty for the sole purpose of training or processing and a permanent change of station.
- “Operates at a loss” would mean negative net income as allowed under California law.<sup>1</sup>
- “Small business” would mean a corporation or LLC with total income of \$250,000 or less.

### IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

1. Under this bill, a member of the Armed Forces could be deployed to a location where there is no combat during a period when a Presidential Executive order specifies that the U.S. is engaged in combat or homeland defense and be permitted the benefit the bill would create. If it is the intent of the author to limit the benefit of the bill to a member of the Armed Forces deployed to a combat zone, it is recommended that the bill be amended to specify the intended limitation.
2. This bill would require the FTB to promulgate regulations to define the term “ceases operations.” It is recommended that the author change “shall” to “may” and provide that the FTB may prescribe regulations as necessary or appropriate to carryout the purposes of this selection, including a definition for “ceases operations.”
3. This bill would be specifically inoperative on January 1, 2018, which is problematic for fiscal year taxpayer’s with year-ends that are different from December 31<sup>st</sup>. It is recommended that the inoperative date be revised to “taxable years beginning on or after January 1, 2018.”

### TECHNICAL CONSIDERATIONS

The department has identified the following technical concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

1. LLC’s that are not classified as corporations pay an “annual tax” instead of a “minimum franchise tax.” On page 3, line 12, the author should replace “minimum franchise tax” with “the tax imposed under subdivision (a),” which reference the annual tax.
2. The bill’s reference to “the limited liability company operates at a loss” is technically incorrect because an LLC that is not classified as a corporation would compute the income or loss at the “owner” level and not at the LLC “entity” level.

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<sup>1</sup> Revenue and Taxation Code (R&TC) section 24341. “Net income” means the gross income, computed under Chapter 6 (commencing with Section 24271), less the deductions allowed under this article and Article 2 (commencing with Section 24401).

## ECONOMIC IMPACT

### Revenue Estimate

Estimated Revenue Impact of AB 2671 Operative For Tax Years Beginning On or After January 1, 2010 Assumed Enactment Date Before June 30, 2010		
2010/2011	2011/2012	2012/2013
*	*	*
* Negligible revenue loss, less than \$100,000.		

Although the bill would now apply to solely owned LLC's in addition to corporations, the bill's new small business limitation offsets any revenue impact, therefore, the bill's revenue impact again is negligible.

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

## LEGAL IMPACT

The bill limits the application of its provisions to a small business with "total income of \$250,000 or less." "Total income" would include worldwide income earned from within and outside of the state. The author may want to include after "total income" the phrase "from all sources derived from or attributable to the state" to limit the threshold to California receipts in order to avoid possible constitutional challenges in the future from using sources outside of the state to determine a California limitation.

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## **APPENDIX A**

### **IMPLEMENTATION CONCERNS DISCUSSED IN THE DEPARTMENT'S ANALYSIS OF THE BILL AS INTRODUCED FEBRUARY 19, 2010**

Under this bill, a member of the Armed Forces could be deployed to a location where there is no combat during a period when a Presidential Executive order specifies that the U.S. is engaged in combat or homeland defense and be permitted the benefit the bill would create. If it is the intent of the author to limit the benefit of the bill to a member of the Armed Forces deployed to a combat zone, it is recommended that the bill be amended to specify the intended limitation.

This bill would apply only to corporations. If it is the intent of the author to provide an exemption of the \$800 minimum franchise tax to all business entities, namely LLCs, limited partnerships, Qualified Subchapter S, and foreign corporations, it is suggested that the bill be amended.