

SUMMARY ANALYSIS OF AMENDED BILL

Author: Florez Analyst: Angela Raygoza Bill Number: SB 392

Related Bills: See Prior Analysis Telephone: 845-7814 Amended Date: June 24, 2009

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Limited Liability Companies/Contractors

_____ 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 AMENDED

April 21, 2009, STILL APPLIES.

OTHER – See comments below.

SUMMARY

This bill would allow contractors to form as limited liability companies (LLCs).

SUMMARY OF AMENDMENTS

The June 24, 2009, amendments would modify the changes related to the insurance bond requirements and require this bill to become operative January 1 following the year the Contractors’ State License Board (CSLB) receives sufficient appropriation to implement this bill.

As a result of the June 24, 2009, amendments, the “Effective/Operative Date,” “This Bill,” and “Economic Impact” discussions, as provided in the department’s analysis of the bill as amended April 21, 2009, have been revised. The remainder of that analysis still applies.

This analysis does not address the bill's changes to the Business and Professions Code related to the insurance bond requirements as they do not impact the department.

Board Position:	Legislative Director	Date
_____ S	Brian Putler	8/19/09
_____ NA		
_____ SA		
_____ N		
_____ NP		
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_____ NAR		
<input checked="" type="checkbox"/> PENDING		

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010, and would be operative January 1 of the year following the effective date of the annual budget bill in which the CSLB receives an appropriation for sufficient resources to implement this bill and the CSLB notifies the Secretary of State and Legislative Counsel that there is such an appropriation.

ANALYSIS

THIS BILL

This bill would allow an individual or a business providing services as a contractor to form and operate as an LLC. In addition, this bill would authorize the CSLB to issue a contractor’s license to an LLC under the Business and Professions Code. Any LLC would be treated in the same manner as a corporation relative to the issuance, renewal, suspension, re-issuance, or termination of a contractor’s license.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gains:

Estimated Revenue Impact of SB 392 Effective for Taxable years Beginning On or After January 1, 2011 Enacted after September 1, 2009 (\$ in Millions)			
2009-10	2010-11	2011-12	2012-13
\$0	\$2	\$9	\$12

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

Revenue Discussion

The revenue impact of this bill would be estimated as the difference in the tax revenue collected under existing and proposed laws. Under existing law, nearly all licenses issued by the Contractors’ State License Board are for individuals. Individual contractors must file returns with the FTB to pay taxes on their contracting business income. If this bill is enacted, some individual contractors may decide to convert to LLC’s. An LLC often elects treatment as a partnership for tax purposes. As such, an LLC must pay a minimum tax of \$800, an LLC fee that would be based on the LLC’s total income, and must pass through all the profit or loss to its owners. Pass-through profits or losses are taxable to the individual owners. It is assumed if the individual contractor converts to an LLC that the taxes on an individual contractor’s business income under existing law would be equal to the taxes on an owner’s pass-through profits. Thus, the revenue

impact of this bill would be equal to the taxes and fees paid by the new LLCs that would be created by this bill. This bill changes the operative date to January 1 of the year following the effective date of the annual budget bill in which the Contractors' State License Board receives an appropriation for sufficient resources to implement this act. This analysis assumes the bill would be operative for taxable years beginning on or after January 1, 2011. The impact was estimated in the following steps.

First, data from the Contractors' State License Board was merged with 2005 tax return samples to identify individual contractors with income reported on a Schedule C. Only building and specialty trade contractors were considered for this analysis.

Next, the potential LLC taxes and fees to be collected would be estimated assuming that all individual contractors would convert into LLCs. Based on the above data from the Contractors' State License Board and FTB tax returns, the gross impact would be estimated at \$111 million for 2005. The estimated 2005 revenue impact was extrapolated for future years, assuming an annual growth rate of 2 percent. For example, the 2005 gross impact of \$111 million was extrapolated to \$125 million for the 2011 taxable year. The \$125 million would be further adjusted to account for (1) the conversion rate from individual contractors to LLC, (2) missing data, (3) contractors other than building and specialty trade contractors may convert to LLC, (4) the \$1 million insurance requirement, (5) not all individual contractors are aware of this program. For the 2011 taxable year, it was assumed that approximately 4,993 individual contractors would convert into an LLC, resulting in a revenue gain of approximately \$9 million. (\$125 million gross impact x 7% conversion rate x 1.45% for missing data x 1.05% for other contractors x 90% for \$1 million insurance requirement x 75% awareness in 2011 ≈ \$9 million)

Finally, the taxable-year estimates were converted to fiscal-year estimates that are shown in the above table. For example, the revenue impact of \$9 million for the 2011-12 fiscal year consists of \$5 million from the 2011 taxable year and \$4 million from the 2012 taxable year.

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