Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Logue	Analyst:	Jessica Matus	Bill Number:	AB 1240
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	March 31, 2011
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Minimum Franchise Tax/$100 For Limited Liability Company Small Businesses

SUMMARY

This bill would reduce the annual tax to $100 for Limited Liability Companies (LLCs) that are small businesses.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

Summary of Amendments

The March 31, 2011, amendments removed provisions that would have made non-substantive changes related to disasters and replaced them with the provisions to change the annual tax for small business LLCs to $100 discussed in this analysis. This is the department's first analysis of the bill.

Summary of Suggested Amendments

Amendments have been provided to replace the term "minimum franchise tax" with the term "annual tax" for LLCs.

PURPOSE OF THE BILL

It appears the purpose of the bill is to encourage small business LLCs to continue to operate in California by reducing the mandatory taxes to do so.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2011.

Board Position:			Executive Officer	Date
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ANALYSIS

FEDERAL/STATE LAW

Under existing state law, unless specifically exempted by statute, every corporation organized, qualified to do business, or doing business in this state, whether organized in state or out of state, is subject to the Minimum Franchise Tax (MFT). Every corporation that incorporates or qualifies to do business in this state is exempt from the MFT for the first taxable year of existence. This exemption is inapplicable to any corporation that reorganizes or changes solely for the purpose of avoiding payment of the MFT. In addition, the first-year exemption is inapplicable to the annual taxes paid by LPs, LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, financial asset securitization investment trusts, or Q-Subs.

Corporate taxpayers must pay the greater of the measured franchise tax (herein “franchise tax”) or the MFT. Currently, the franchise tax rate for corporate taxpayers is 8.84 percent. Corporate taxpayers with net income of less than approximately $9,040 pay only the MFT because the amount of “franchise” tax owed would be less than $800 ($9,039 x 8.84% = $799).

Real estate mortgage investment conduits (REMICs) 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.

Limited partnerships (LPs), limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), and qualified Subchapter S subsidiaries (Q-Subs) are required to pay an annual tax equal to the MFT, but are not subject to a “franchise” tax.

THIS BILL

For taxable years beginning on or after January 1, 2011, this bill would reduce the annual tax for small business LLCs not classified as a corporation from $800 to $100.

A “small business” is defined as an LLC with total income from all sources derived from, or attributable to, the state of $250,000 or less.

IMPLEMENTATION CONSIDERATIONS

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.

TECHNICAL CONSIDERATIONS

This bill uses the term “minimum franchise tax” for LLCs. These entities pay an “annual tax” equal to the MFT. It is recommended that the bill be amended to use the term “annual tax” instead of “minimum franchise tax.” To address this concern, the following amendment has been provided:

> On page 3, line 33, strikeout “minimum franchise tax” and insert “annual tax”.

LEGISLATIVE HISTORY

AB 166 (Cook, 2011/2012) would eliminate the MFT. This bill is currently in the Assembly Revenue and Taxation suspense file.

AB 821 (Garrick, 2011/2012) would change the MFT to $100 for qualified small businesses. This bill is currently in the Assembly suspense file.

AB 327 (Garrick, 2009/2010) would have reduced the MFT from $800 to $100. AB 327 failed passage out of the Assembly by the constitutional deadline.

AB 1179 (Garrick, 2007/2008) would have reduced the MFT from $800 to $100. AB 1179 failed passage out of the Assembly Revenue and Taxation Committee.

AB 2178 (Garrick, 2007/2008) would have reduced the MFT from $800 to $200. AB 2178 failed passage out of the Assembly Revenue and Taxation Committee.

AB 1419 (Campbell, 1997/1998) would have reduced the MFT from $800 to $100. AB 1419 failed passage out of the Senate Revenue and Taxation Committee.

OTHER STATES' INFORMATION

The states surveyed include *Arizona, Florida, Illinois, Massachusetts, Michigan, Minnesota, Nevada, New York, Oregon, and Utah.* These states were selected due to their geographic proximity to California or their similarities to California's economy, business entity types, and tax laws.

Florida, Michigan, and Minnesota do not impose a minimum tax on business entities.

Arizona and *Illinois* do not impose a minimum tax on LLCs.

Massachusetts imposes a filing fee of $500 on LLCs.

Nevada does not impose income tax on business entities conducting business within the state. *Nevada* does require all businesses to pay an annual “business license fee” to the Nevada Department of Taxation for the privilege of doing business within the state. For the first year an entity does business within the state, the entity is required to pay a $200 license fee and is required to pay a $100 license fee for each subsequent year it does business within the state.

New York imposes a minimum tax of $25 to $4,500 on LLCs based on their in-state receipts.

Oregon imposes a $150 minimum tax LLCs.

Utah does not impose a minimum tax on LLCs.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 1240 For Taxable Years Beginning On or After January 1, 2011 Enactment Assumed After June 30, 2011 ($ in Millions)			
2011-12	2012-13	2013-14	2014-15
-$190	-$190	-$210	-$240

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Pro: Proponents would argue that this bill would make California more competitive with other states for small business LLCs.

Con: Opponents would argue that the annual tax does not discourage business because small businesses can simply organize as sole proprietorships to avoid paying the MFT or annual tax.

POLICY CONCERNS

This bill would provide a tax benefit for LLCs that would not be provided to other business entities. Thus, this bill would provide differing treatment based solely on business type.

The bill would define a small business as "LLCs with total income from all sources derived from or attributable to, the state of $250,000 or less." This definition may be interpreted to include the LLC subsidiaries of large corporate taxpayers that file a combined return as "small businesses." If the author's intent is to disallow this reduction specifically for LLCs that are owned, in whole or in part, by large businesses, it is recommended the bill be amended to specify this disallowance.

LEGISLATIVE STAFF CONTACT

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