

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Calderon & Dababneh Analyst: Janet Jennings Bill Number: AB 2086
Related Bills: See Legislative History Telephone: 845-3495 Amended Date: April 21, 2014
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Annual Tax/Annual Fee/ Change Payment Dates

SUMMARY

This bill under the Personal Income Tax Law (PITL) and Corporation Tax Law would modify the due dates for payments of the annual tax and annual fee for Limited Liability Companies (LLCs) and the minimum tax due for corporations.

RECOMMENDATION

No position.

Summary of Amendments

The April 21, 2014, amendments added a coauthor, removed provisions of the bill related to Secretary of State fees, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for the bill is to provide payment options to LLCs and corporations to reduce the burden of paying in one lump sum payment.

EFFECTIVE/OPERATIVE DATE

This bill would become effective on January 1, 2015, and operative for fees and taxes due on or after that date.

ANALYSIS

FEDERAL/STATE LAW

Federal Law

Under federal law, all corporations are required to file an annual tax return whether or not they have taxable income. Corporations with taxable income are taxed at graduated tax rates that vary from 15 percent to 35 percent.

Board Position:

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Executive Officer

Date

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5/5/14

Federal law has no minimum franchise tax on business entities comparable to the California minimum franchise or annual tax.

In general, federal law requires corporations to make estimated tax payments if the corporation expects to owe \$500 or more in tax. Estimated taxes are due in four equal installments of 25 percent each.

Additionally, federal law requires that an LLC with more than two members be classified as a partnership for federal tax purposes unless it specifically elects to file as a corporation. Federal law has no requirement for partnerships to pay annual fees or minimum tax.

State Law

State law currently requires LLCs not classified as corporations that are organized, registered, or doing business in the state to pay an annual tax, in an amount equal to the minimum franchise tax, which is currently \$800. Every LLC subject to the annual tax is also required to pay an annual fee based on the total income from all sources derived from or attributable to the state. The fee must be estimated and paid no later than the 6th month of the taxable year. A penalty of 10 percent of the amount of underpayment would be added to any fee paid late.

Under existing state law, the annual tax on limited partnerships, limited liability partnerships (LLPs), LLCs not classified as corporations and real estate mortgage investment conduits (REMICs) is set at \$800 by reference to the minimum franchise tax.

In general, taxes are due on income as it is earned. If the income is not subject to withholding, individual and corporate taxpayers are required to remit estimated tax payments. If a corporation's estimated tax does not exceed the minimum franchise tax, the entire amount of the minimum franchise tax is payable as the 1st estimated tax payment. If the amount of estimated tax exceeds the minimum franchise tax after the last day of the 3rd month and before the 1st day of the 6th month of the corporation's taxable year, the 2nd, 3rd, and 4th estimated tax payments are remitted quarterly as 30 percent, 40 percent, 0 percent, 20 percent of the required annual payment.

Generally, a taxpayer is subject to a penalty for any underpayment of estimated tax. The underpayment rate is the same as the interest rate charged for tax delinquencies. The penalty is calculated by comparing the required amount for each estimated tax payment, determined under either the regular method or the "annualized income installment method." The regular method requires estimated payments of 30 percent, 40 percent, 0 percent, 20 percent of the required annual payment. Corporations not required to make an estimated tax payment for the first quarter are required to make estimated tax payments of 60 percent, 0, and 40 percent for the 2nd, 3rd, and 4th quarter installments, respectively. Corporations not required to make an estimated tax payment for the first and second quarter are required to make estimated tax payments of 100 percent, and 0, for the 3rd, and 4th quarter installments, respectively.

Current California law provides that interest is charged on underpayments of tax from the last day prescribed for payment to the date the payment is made. The last day prescribed for payment is the date the tax liability arises, not later than the date the notice and demand is made by the Franchise Tax Board (FTB). This generally is the due date of the tax return, without regard to extension.

Current state law imposes penalties when a taxpayer fails to file a tax return on or before its due date or fails to pay the tax due as shown on their tax return by the due date of the return. The penalties apply to individuals, corporations, partnerships, LLCs, and S corporations.

THIS BILL

This bill would replace the specified due date for the LLC fee and annual tax, and corporation minimum franchise tax, with three payment options as described below.

An LLC may choose from the following options:

Annual Tax

- Payment in full due on or before the 15th day of the fourth month of the taxable year,
- In three equal installments due on or before the 15th day of the 4th, 8th, and 12th months of the taxable year, or
- In two equal installments, with the first installment due on or before the 15th day of the fourth month of the taxable year and the second installment due on or before 12 months of that date.

Fee

The fee assessed would be collected and refunded in the same manner as the taxes imposed under the Personal Income Tax Law, and would be subject to interest and applicable penalties and would be due and payable according to one of the following:

- On the date the return of the LLC is required to be filed under Section 18633.5.¹
- In three equal installments on or before the 15th day of the 4th, 8th, and 12th months.
- In two equal installments, with the first installment due on or before the 15th day of the fourth month from the date the return of the LLC is required to be filed Section 18633.5² and the second installment on or before 12 months of that date.

Corporations may choose from the following options:

- Payment in full due on or before the 15th day of the fourth month of the taxable year.
- In three equal installments due on or before the 15th day of the 4th, 8th, and 12th months of the taxable year.
- In two equal installments, with the first installment due on or before the 15th day of the fourth month of the taxable year and the second installment due on or before 12 months of that date.

¹ On or before the fifteenth day of the fourth month following the close of its taxable year.

² Ibid.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill lacks a process for a taxpayer to select a payment option and report that selection to the FTB. Generally, a taxpayer is required to make a binding election to provide certainty for both the taxpayer and the department. Additionally, a binding election would provide the information needed to determine when interest and a late or underpayment penalty would apply.

Because the penalty and interest provisions are unchanged, a taxpayer that made payments as described in one of the payment options could be subject to interest and penalties.

TECHNICAL CONSIDERATIONS

The bill uses the phrase, "and the second installment on or before 12 months of that date" which is not clearly worded. Amendments 1-3 are provided to change the phrase to "and the second installment on or before 12 months after the date of the first installment," which may be less confusing.

LEGISLATIVE HISTORY

AB 1769 (Dababneh, 2013/2014) would exempt certain small business LLCs from the minimum franchise tax for up to two taxable years. AB 1769 is pending before the Assembly Revenue and Taxation Committee.

AB 1889 (Hagman, 2013/2014) would exempt certain small business entities from the minimum franchise tax for up to the first two taxable years. AB 1889 is pending before the Assembly Revenue and Taxation Committee.

AB 2428 (Patterson, 2013/2014) would eliminate the minimum franchise tax for new business entities for up to five taxable years. AB 2428 is pending before the Assembly Revenue and Taxation Committee.

AB 2466 (Nestande, 2013/2014) would either exempt or reduce certain, veteran owned small business entities from the minimum franchise tax. AB 2466 is pending before the Assembly Revenue and Taxation Committee.

AB 2495 (Melendez, 2013/2014) would eliminate the minimum franchise tax for new business entities for up to five taxable years. AB 2495 is pending before the Assembly Revenue and Taxation Committee.

SB 641 (Anderson, 2013/2014) would eliminate the minimum franchise tax for certain new corporations for the first four taxable years. SB 641 is currently in the Senate Appropriations Committee.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable alternative payment schedule similar to the alternative this bill would establish. These states were selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The department's costs to administer this bill are unable to be determined until implementation concerns have been resolved. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

The impact to the general fund revenues cannot be estimated until the implementation concerns have been resolved. For example, the due date of taxes, and effective application dates for penalties, and interest are uncertain.

SUPPORT/OPPOSITION

Support: None Provided.

Opposition: None Provided.

ARGUMENTS

Proponents: Some may argue that the bill would give LLCs and corporations a needed flexibility of when to pay the taxes and fees due and therefore reduce the burden of making a large onetime payment.

Opponents: Some may argue that this alternative payment schedule increases the already difficult to estimate cash flow to the general fund and may be viewed as an unfair practice by taxpayers not afforded this flexibility.

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FRANCHISE TAX BOARD
PROPOSED AMENDMENTS TO AB 2086
AS AMENDED APRIL 21, 2014

AMENDMENT 1

On page 3, line 22, strike “of that date.” and insert:

“after the date of the first installment.”

AMENDMENT 2

On page 6, line 17 and 18, strike “of that date.” and insert:

“after the date of the first installment.”

AMENDMENT 3

On page 7, line 3, strike “of that date.” and insert:

“after the date of the first installment.”