

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Chau Analyst: Diane Deatherage Bill Number: AB 2244
Related Bills: See Legislative History Telephone: 845-4783 Introduced Date: February 21, 2014
Attorney: Bruce Langston Sponsor:

SUBJECT: Minimum Franchise Tax/\$200 for Dormant Business Entities & \$50 for Inactive Business Entities

SUMMARY

This bill would reduce the minimum franchise tax or annual tax, whichever applies, for dormant and inactive business entities under the Corporation Tax Law.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to reduce the minimum franchise tax or annual tax that would otherwise be due from a business entity for the period that the entity was dormant or inactive.

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, 2015.

ANALYSIS

FEDERAL

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

STATE LAW

Unless specifically exempted by statute, every corporation that is organized or 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. Taxpayers must pay the minimum franchise tax only if it is more than their measured franchise tax. For taxable years beginning on or after January 1, 1997, only taxpayers whose net income is less than approximately \$9,040 pay the minimum franchise tax because their measured tax would be less than \$800 (\$9,039 x 8.84% = \$799).

Table with Board Position (S, SA, N, NA, O, OUA, NP, NAR) and Executive Officer (Selvi Stanislaus) with Date (04/01/14).

Every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, is exempt from the minimum franchise tax for its first taxable year. This exemption does not apply to any corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax. It also does not apply to limited partnerships, limited liability companies not classified as corporations, limited liability partnerships, charitable organizations, regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, financial asset securitization investment trusts, and qualified Subchapter S subsidiaries.

Real estate mortgage investment conduits are subject to and required to pay the minimum franchise tax. Regulated investment companies and real estate investment trusts organized as corporations also are subject to and required to pay the minimum franchise tax.

Under existing state law, the annual tax on limited partnerships, limited liability companies not classified as corporations, limited liability partnerships, and qualified Subchapter S subsidiaries is set at \$800 by reference to the minimum franchise tax.

A corporation wholly owned by an individual that is a member of the U.S. Armed Forces is exempt from paying the minimum franchise tax for any taxable year if both of the following apply:

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

THIS BILL

For taxable years beginning on or after January 1, 2014, this bill would reduce the minimum franchise tax or annual tax, whichever applies, to \$200 for a dormant business entity and to \$50 for an inactive business entity.

This bill would define the following terms:

- "Business entity" means a corporation, a limited partnership,¹ a limited liability company,² a limited liability partnership³, a charitable corporation,⁴ a regulated investment company,⁵ a real estate investment trust,⁶ a real estate mortgage investment conduit,⁷ or a qualified Subchapter S subsidiary.⁸

¹ As defined in R&TC Section 17935.

² As defined in R&TC Section 17941.

³ As defined in R&TC Section 17948.

⁴ As described in R&TC Section 23703.

⁵ As defined in IRC Section 851.

⁶ As defined in IRC Section 856.

⁷ As defined in IRC Section 860D.

⁸ As defined in IRC Section 1361(b)(3)(B).

- "Dormant business entity" means a business entity that is organized under the laws of this state or has qualified to transact intrastate business in this state, and that certifies, under penalty of perjury, on its tax return, that it was not doing business, within the meaning of subdivision (a) of Section 23101, in this state for the taxable year. A business entity may be a dormant business entity for no more than five consecutive taxable years.
- "Inactive business entity" means a business entity, other than a limited partnership or a limited liability partnership, that is organized under the laws of this state or has qualified to transact intrastate business in this state, and that reasonably believes that it will not be doing business, within the meaning of subdivision (a) of Section 23101, in this state for the taxable year. A business entity may be an inactive business for no more than five consecutive taxable years.

This bill would also require an inactive business that was in fact doing business in California to pay an additional \$750 by the original due date of the return.

This bill would expand the crime of perjury and impose a state-mandated local program.

IMPLEMENTATION CONSIDERATIONS

Because the bill fails to specify otherwise, a business entity could qualify as a dormant business entity for the maximum five year period and subsequently qualify as an inactive business for an additional five years. If the author intends to limit the reduced tax or annual fee to one five year period, this bill should be amended.

TECHNICAL CONSIDERATIONS

To clarify the definitions of "dormant business entity" and "inactive business entities", amendment language has been provided in Amendment 1.

LEGISLATIVE HISTORY

AB 990 (Conway, 2013/2014) would have reduced the minimum franchise tax from \$800 to \$700. AB 990 failed passage out of the Assembly by the constitutional deadline.

AB 1769 (Dababneh, 2013/2014) would reduce the annual fee for specified new limited liability companies for the first two taxable years. AB 1769 is currently pending hearing in the Assembly and Taxation Committee.

AB 1889 (Hagman, 2013/2014) would reduce the minimum tax for certain new business entities. AB 1889 is in the Assembly Revenue and Taxation Committee.

AB 2428 (Patterson, 2013/2014) would reduce the minimum tax and annual fees for business entities that incorporated or files with the Secretary of State on or after January 1, 2014, for the first five taxable years. AB 2428 is in the Assembly Revenue and Taxation Committee.

AB 2466 (Nestande, 2013/2014) would reduce the minimum franchise tax to \$99 for new veteran-owned small business entities and would eliminate the tax if the business entity operates at a loss or ceases operation. AB 2466 is in the Assembly Revenue and Taxation Committee.

AB 2495 (Melendez, 2013/2014) would exempt certain new business entities from the minimum franchise tax or annual fees for the first consecutive five taxable years. AB 2495 is in the Assembly Revenue and Taxation Committee.

SB 641 (Anderson, 2013/2014) would have exempted qualified new corporations from the minimum franchise tax for its second, third and fourth taxable years. SB 641 failed passage out of the Senate by the constitutional deadline.

AB 166 (Cook, 2011/2012) would have eliminated the minimum franchise tax. AB 166 failed passage out of the Assembly by the constitutional deadline.

AB 368 (Morrell, 2011/2012) would have reduced the minimum franchise tax to \$400 for qualified small businesses. AB 368 failed passage out of the Assembly by the constitutional deadline.

AB 821 (Garrick, 2011/2012) would have reduced the minimum franchise tax from \$800 to \$100 for a small business for the first ten years of operation. AB 821 failed passage out of the Assembly by the constitutional deadline.

AB1605 (Garrick, 2011/2012) would have exempted specified entities from the minimum franchise tax or annual tax and reduced the minimum franchise tax or annual tax to \$99 for specified entities that commence business on or after January 1, 2013. AB 1605 failed passage out of the Assembly by the constitutional deadline.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to 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.

Illinois imposes a \$25 minimum tax on corporations.

Massachusetts imposes a \$456 minimum tax on corporations.

New York imposes a minimum tax on corporations of \$25 to \$5,000 based on the corporation's in-state receipts. It also imposes a minimum tax of \$25 to \$4,500 for Limited Partnerships, Limited Liability Companies, and Limited Liability Partnerships based on their in-state receipts.

FISCAL IMPACT

This bill would impact the department’s printing, processing and programming costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

| Estimated Revenue Impact of AB 2244 As Introduced February 21, 2014 Assumed Enactment After June 30, 2014 (\$ in Millions) | | |
|-------------------------------------------------------------------------------------------------------------------------------------|---------|---------|
| 2014-15 | 2015-16 | 2016-17 |
| - \$2.5 | - \$8.5 | - \$14 |

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

Proponents: Some could argue that reducing the applicable minimum franchise or annual tax would ease the financial burden of dissolution on dormant or inactive business entities.

Opponents: Some could argue that reducing the minimum franchise tax would discourage a business entity from dissolving in a timely manner.

LEGISLATIVE STAFF CONTACT

Diane Deatherage
Legislative Analyst, FTB
(916) 845-4783
diane.deatherage@ftb.ca.gov

Mandy Hayes
Revenue Manager, FTB
(916) 845-5125
mandy.hayes@ftb.ca.gov

Gail Hall
Legislative Director, FTB
(916) 845-6333
gail.hall@ftb.ca.gov

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|-------------|------------------|
| Analyst | Diane Deatherage |
| Telephone # | (916) 845-4783 |
| Attorney | Bruce Langston |

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2244
As Introduced February 21, 2014

AMENDMENT 1

Page 6, line 34 strikeout "on its return,", insert:

with its return for the taxable year

Page 6, line 35, strikeout "of subdivision (a)".

Page 6, line 36, strikeout "the" and insert:

that

Page 6, line 37, after "than", insert:

one period of no more than

Page 7, lines 2 and 3, strikeout "of subdivision (a)".

Page 7, line 3, strikeout "the" and insert:

that

Page 7, line 4 after "than", insert:

one period of no more than