Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nestande	Analyst:	Jessica Deitchman	Bill Number:	AB 2466
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date:	February 21, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Minimum Franchise Tax/$99 for New Veteran-Owned Small Businesses

SUMMARY

This bill would, under the Corporation Tax Law, reduce or eliminate the minimum franchise tax for new veteran-owned small corporations.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to provide tax relief for new veteran-owned small corporations doing business in California, by reducing or eliminating the minimum franchise tax.

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, and before January 1, 2018.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

<u>Federal Law</u>

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

<u>State Law</u>

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).

Board Position:			Executive Officer	Date
_______ S	_______ NA	___X___ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	04/14/14
_______ N	_______ OUA			

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 tax on limited partnerships, limited liability companies not classified as corporations, and limited liability partnerships 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.

<u>THIS BILL</u>

This bill would, for taxable years beginning on or after January 1, 2015, and before January 1, 2018, either reduce or exempt a new veteran-owned small corporation’s minimum franchise tax.

If the new veteran-owned small corporation estimates that it will have $1 million or less in gross receipts, in that taxable year, the minimum franchise tax would be $99.

If the new veteran-owned small corporation operates at a loss or ceases operations, the minimum franchise tax would be eliminated for the taxable year.

This bill would define the following terms:

- “New Veteran-Owned Small Business” means a corporation that is incorporated under the laws of the state or has qualified to transact intrastate business in the state on or after January 1, 2015, and begins business operations at or after the time of its organization. Excluded from this definition are any corporations that began business operations as a sole proprietorship, a partnership, or any other form of business entity prior to its incorporation.

- "Gross receipts, less returns and allowances reportable to this state," means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of Section 25120[1] and the gross receipts from the production of non-business income, as defined in subdivision (d) of Section 25120.[2] In addition, the determination of the gross receipts of a corporation would be made by including the gross receipts of each member of the commonly controlled group, as defined in Section 25105, of which the corporation is a member.
- "Operates at a loss," means negative income as defined in Section 24341 that is below zero.
- "Veteran," means a person honorably discharged from the Armed Forces of the United States.

The provisions of this bill would be inapplicable to any corporation that reorganizes solely for the purpose of reducing its minimum tax.

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.

The provisions of this bill would apply to all new small business corporations because the definition of "new veteran-owned small business" fails to specify that the business be owned, in whole or in part, by a veteran. If this is contrary to the author's intent, this bill should be amended.

This bill would reduce the minimum franchise tax for qualified taxpayers that estimate their gross receipts to be less than $1 million. If the taxpayer incorrectly estimates the gross receipts and it is later determined that the gross receipts were in excess of $1 million, because the bill fails to specify otherwise, the reduced minimum franchise tax could apply, regardless of the actual gross receipts. If this is inconsistent with the author's intent, it is recommended the bill be amended to specify that if a taxpayer's gross receipts exceed $1 million, the additional tax would be due and payable on the due date of the return.

TECHNICAL CONSIDERATIONS

On page 6, line 29 after "negative" insert "net"

On page 6, line 31, strikeout "a person" and insert "an individual"

[1] "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.
[2] "Nonbusiness income" means all income other than business income.

LEGISLATIVE HISTORY

AB 1769 (Dababneh, 2013/2014) would exempt certain small business limited liability companies (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 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.

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.

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.

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.

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

AB 2126 (Garrick, 2009/2010) would have reduced the minimum franchise tax to $100 for qualified small businesses. AB 2126 failed passage out of the Assembly Revenue and Taxation Committee.

AB 1179 (Garrick, 2007/2008) would have reduced the minimum franchise tax 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 minimum franchise tax from $800 to $200. AB 2178 failed passage out of the Assembly Revenue and Taxation Committee.

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

Department staff is unable to determine the costs to administer this bill until the 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

Revenue Estimate

Estimated Revenue Impact of AB 2466* As Introduced February 21, 2014 For Taxable Years Beginning On or After January 1, 2015 And Before January 1, 2018 Assumed Enactment After June 30, 2014 ($ in Millions)		
2015-16	2016-17	2017-18
- $15	- $65	- $55

*No revenue impact in 2014-15 because corporations are exempt from the minimum franchise tax in their first year under current law.

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 taxpayers may argue that the bill would give a needed tax break to new veteran-owned small corporations in California and therefore encourage them to stay in business.

Opponents: Some taxpayers may argue that providing a tax break only to new veteran-owned small corporations may be overly narrow and inadvertently exclude other business owners that need assistance as well.

POLICY CONCERNS

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

LEGISLATIVE STAFF CONTACT

Jessica Deitchman	Mandy Hayes	Gail Hall
Legislative Analyst, FTB	Revenue Manager, FTB	Legislative Director, FTB
(916) 845-6310	(916) 845-5125	(916) 845-6333
jessica.deitchman@ftb.ca.gov	mandy.hayes@ftb.ca.gov	gail.hall@ftb.ca.gov