ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Nestande, et al.	Analyst:	Jessica Deitchman	Bill Number:	AB 2466
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	May 15, 2014
		Attorney:	Bruce Langston	Sponsor:	

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

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), reduce or eliminate the minimum franchise tax or annual tax for new veteran-owned small corporations and limited liability companies (LLC).

RECOMMENDATION

No position.

Summary of Amendments

The May 15, 2014 amendments added LLCs as a business entity type that is eligible for the exemption or reduction to the annual tax. This analysis replaces the department's analysis of the bill as introduced February 21, 2014 and amended March 27, 2014.

REASON FOR THE BILL

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

FEDERAL/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).

Board Position:			Executive Officer	Date
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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, for taxable years beginning on or after January 1, 2015, and before January 1, 2018, would modify the amount of minimum franchise tax or annual tax required to be paid by the following corporations and LLCs:

- A corporation or LLC that is a new veteran-owned small business would pay annually to the state a minimum franchise tax or annual tax in the amount of $99.
- A corporation or LLC that is a new veteran-owned small business would not be subject to the minimum franchise tax or annual tax if that business operates at a loss or ceases operations.

This bill would define the following terms:

- "New veteran-owned small business" means either:
    - o 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 incorporation and that has total income derived from, or attributable to, the state of $250,000 or less. 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; or

  - A veteran-owned LLC that is formed under the laws of this state or has qualified to transact intrastate business in this state on or after January 1, 2015, that begins business operations at or after the time of its formation, and that has a total income derived from, or attributable to, the state of two hundred fifty thousand dollars ($250,000) or less. "New veteran-owned small business" does not include any limited liability company that began business operations as a sole proprietorship, a partnership, a corporation, or any other form of business entity prior to its formation.

- "Operates at a loss," for a corporation means negative net income as defined in Section 24341.
- "Operates at a loss," for an LLC means the LLC's expenses exceed its receipts.
- "Veteran," means an individual honorably discharged from the Armed Forces of the United States.
- "Veteran-owned Corporation" means either:

  - A corporation in which stock representing more than 50 percent of the voting power of the corporation and representing more than 50 percent value of the stock of the corporation is owned by one or more veterans; or
  - A limited liability company in which more than 50 percent of the membership interest is owned by one or more veterans.

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

IMPLEMENTATION CONSIDERATIONS

The term "total income derived from or attributable to the state" is undefined. The absence of definitions to clarify this term could lead to disputes with taxpayers and would complicate the administration of this exemption.

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 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 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.

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 costs have yet to be determined. 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 Amended May 15, 2014 Assumed Enactment After June 30, 2014 ($ in Millions)		
2014-15	2015-16	2016-17
- $4.0	- $9.5	- $18

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

SUPPORT/OPPOSITION[1]

Support: Michelle Steel, Board of Equalization.

Opposition: California Tax Reform Association.

ARGUMENTS

Proponents: Some taxpayers may argue that the bill would give a needed tax break to new veteran-owned small corporations and LLCs 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 and LLCs 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 and LLCs that would not be provided to other business entities. The bill also provides different definitions for LLCs and Corporations when defining "operating at a loss." Thus, this bill would provide differing treatment based solely on business type.

LEGISLATIVE STAFF CONTACT

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[1] As stated in the Assembly Committee Analysis dated May 12, 2014.