

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Melendez Analyst: Jessica Deitchman Bill Number: AB 2495
 Related Bills: See Legislative History Telephone: 845-6310 Introduced Date: February 21, 2014
 Attorney: Bruce Langston Sponsor: _____

SUBJECT: Minimum Franchise Tax/Exempt New Corporations, LLC, Limited Partnerships, & Limited Liability Partnerships First Consecutive Five Taxable Years

SUMMARY

This bill would, under both Corporation Income Tax Law (CTL) and Personal Income Tax Law (PITL), exempt newly organized or registered business entities from the minimum tax or annual tax for the first five taxable years.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to provide tax relief for newly formed business entities doing business in California, by exempting them from the minimum franchise or annual tax for the first five years.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for specified business entities that organize or register on or after January 1, 2015.

ANALYSIS

FEDERAL/STATE LAW

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

Board Position:	Executive Officer	Date
_____ S	_____ NA	_____ X NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	
	Selvi Stanislaus	04/09/14

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.

Under existing state law, the annual 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.

Doing Business

Section 23101 defines "doing business" as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit.

Furthermore, a taxpayer will also be considered to be doing business in California if any of the following conditions are satisfied:

- The taxpayer is organized or commercially domiciled in California.
- Sales, as defined in subdivision (f) of Revenue & Taxation Code (R&TC) Section 25120, of the taxpayer in California, including sales by the taxpayer's agents and independent contractors, exceed the lesser of \$500,000 or 25 percent of the taxpayer's total sales.
- Real and tangible personal property of the taxpayer in California exceed the lesser of \$50,000 or 25 percent of the taxpayer's total real and tangible personal property.
- The amount paid in California by the taxpayer for compensation, as defined in subdivision (c) of R&TC Section 25120, exceeds the lesser of \$50,000 or 25 percent of the total compensation paid by the taxpayer.

THIS BILL

This bill would exempt every corporation that incorporates or qualifies to do business in the state on or after January 1, 2015, from the minimum franchise tax for its first five taxable years.

In addition, the bill would exempt the following entities from the annual tax¹ for the first five consecutive taxable years that it is doing business² in the state:

- Limited partnership that files a certificate of limited partnership or a certificate of registration with the Secretary of State (SOS) on or after January 1, 2015.
- Limited liability company that files articles of organization or a certificate of registration with the SOS on or after January 1, 2015.
- Limited liability partnership that registers as a limited liability partnership with the SOS on or after January 1, 2015.

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.

Corporations that organized prior to the effective date of this bill, but do not qualify to do business in the state until after January 1, 2015, would be exempt from payment of the minimum franchise tax, therefore, existing corporations, not just new corporations, could qualify for this bill's exemption. If this is contrary to the author's intent, this bill should be amended.

The bill would provide an exemption from the minimum or annual tax for the first five consecutive years. For those entities not registered in California, the language with respect to a non-California entity could be interpreted to apply to the first period of five consecutive taxable years of doing business, even if there are intervening periods of less than five years of doing business. That five year period for non-California entities could be many years after the non-California entity registers with the SOS. If the author intends for the exemption to apply to the first five years after a non-California entity starts business in California, the bill should be amended.

Because the bill fails to specify otherwise, any business entity that reorganizes solely for the purpose of reducing its minimum tax could qualify for the exemption. If this is contrary to the author's intent, this bill should be amended.

TECHNICAL CONSIDERATIONS

The references to the Corporate Code sections 15623 and 15696 are obsolete and should be deleted.

LEGISLATIVE HISTORY

AB 1769 (Dababneh, 2013/2014) would exempt certain small business limited liability companies from the minimum franchise tax for up to two taxable years. AB 1769 was introduced on February 14, 2014.

¹ In an amount equal to the minimum franchise tax (\$800).

² Revenue and Taxation Code Section 23101.

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 was introduced on February 19, 2014.

AB 2466 (Nestande, 2013/2014) would either exempt or reduce certain small, veteran owned business entities from the minimum franchise tax. AB 2466 was introduced on February 21, 2014.

AB 2428 (Patterson, 2013/2014) would eliminate the minimum franchise tax for new business entities for up to five taxable years. AB 2428 was introduced on February 21, 2014.

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.

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 require changes to the department's forms and instructions, processing, and programming. 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 2495 As Introduced February 21, 2014 For Taxable Years Beginning On or After January 1, 2015 Assumed Enactment After June 30, 2014 (\$ in Millions)		
2014-15	2015-16	2016-17
- \$39	- \$130	- \$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

Proponents: Some taxpayers may argue that providing a limited term exemption from the minimum tax or annual tax would give a needed tax break to newly formed entities in California and therefore encourage them to stay in business.

Opponents: Some taxpayers may argue that providing a limited term exemption to only newly formed entities may be overly narrow and inadvertently exclude other businesses that also need assistance.

LEGISLATIVE STAFF CONTACT

Jessica Deitchman
Legislative Analyst, FTB
(916) 845-6310

jessica.deitchman@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