Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Anderson	Analyst:	Diane Deatherage	Bill Number:	SB 560
Related Bills:	None	Telephone:	845-4783	Amended Date:	April 1, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Exclusion/Amount Received From Disaster or Emergency Related Work Performed During Disaster Period

SUMMARY

Under the Personal Income Tax Law (PITL) and Corporate Tax Law (CTL), this bill would exclude income received by certain entities for performing disaster- or emergency-related work in California during the specified disaster period.

This analysis will not address the bill's changes to the Sales and Use Tax Law, as they do not impact the department or state income tax revenue.

RECOMMENDATION

No position.

Summary of Amendments

The April 1, 2013, amendments removed legislative intent language related to disaster relief, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill. This analysis only addresses the provisions of this bill that impact the department's programs and operations.

REASON FOR THE BILL

The reason for the bill is to relieve companies, that are in California on a temporary basis solely for purposes of helping the state recover from a disaster or emergency, from the burden of taxes as a result of activities in the state.

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, 2014.

ANALYSIS

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

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STATE LAW

A taxpayer is considered "doing business" in California if it actively engages in any transaction for the purpose of financial or pecuniary gain or profit in California or if any of the following conditions are satisfied:

- The taxpayer is organized or commercially domiciled in California.
- The taxpayer's California sales exceed the lesser of $509,500[1] or 25 percent of the taxpayer's total sales.
- The taxpayer's California real and tangible personal property exceed the lesser of $50,950[2] or 25 percent of the taxpayer's total real and tangible personal property.
- The amount paid in California by the taxpayer for compensation exceeds the lesser of $50,950[3] or 25 percent of the total compensation paid by the taxpayer.

For the conditions above, a taxpayer’s sales, property, and payroll include the taxpayer's pro rata or distributive share of pass-through entities (i.e., partnership, a Limited Liability Company (LLC) treated as a partnership, or an "S" corporation).

Every corporation and every LLC taxable as a corporation organized, qualified to do business, or "doing business" in this state is subject to the corporate franchise tax, which is imposed for the privilege of doing business in California. The corporate franchise tax is not imposed on a corporation’s income, but instead it is measured by a corporation’s California source net income. The franchise tax rate is generally 8.84 percent for corporations. Corporations that are not organized in or qualified to do business in California and not "doing business" in California, but are deriving income from California sources, are subject to the corporate income tax. Certain non-corporate business entities, such as business trusts, are also subject to the corporate income tax. The tax rate for S corporations is 1.5 percent. Limited partnerships, limited liability partnerships, and certain other business entities pay an annual tax for the privilege of doing business in California. In many cases this annual tax is equal in amount to the minimum franchise tax of $800.

Effective January 1, 2013, an apportioning trade or business that conducts business both in and out of California is required to apportion its business income using the single sales factor method.[4]

THIS BILL

This bill would for taxable years beginning on or after January 1, 2014, exclude amounts received by a qualified person (as defined) for performing disaster- or emergency-related work in California during the disaster period from income.

[1] Indexed amounts for 2013.
[2] Indexed amounts for 2013.
[3] Indexed amounts for 2013.
[4] R&TC §25128.7

This bill would define the following terms and phrases:

- "Disaster- or emergency-related work" means repairing, renovating, installing, building, or rendering services or other business activities that relate to infrastructure that has been damaged, impaired, or destroyed as a result of a declared state disaster or emergency.
- "Declared state disaster or emergency" means a disaster or emergency event for which the Governor has proclaimed a state of emergency or major disaster or emergency for which the President of the United States has declared to exist in California.
- "Disaster Period" means the period of time that begins no later than 10 days following the Governor's proclamation of a state of emergency or the President's declaration of a major disaster or emergency in California, whichever occurs first, and that extends for a period of 60 calendar days following the termination of the declared disaster or emergency as proclaimed by the Governor or by concurrent resolution by the Legislature[5] or the President of the United States, whichever occurs first.
- "Infrastructure" means property and equipment owned or used by communication networks, gas and electric distribution systems, water pipelines, and public roads and bridges, and related support facilities that service multiple customers or citizens, including, but not limited to, real and personal property, including buildings, offices, power lines, poles, pipes, structures, and equipment.
- "Qualified Person" means, under the PITL, a limited partnership (LP), limited liability partnership (LLP), or LLC, or corporation under the CTL that meets both of the following:

    1. Was not "doing business" in California prior to commencement date of the declared state disaster or emergency, and
    2. Is "doing business" in California after the commencement date of the declared state disaster or emergency upon the request of a registered business or by a state agency or a local agency, for the purpose of performing disaster- or emergency-related work.
- "Registered Business" means a business entity that is registered to do business in this state prior to the commencement date of the declared state disaster or emergency.

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.

As defined in this bill, the disaster period would end after sixty calendar days following the termination of the declared disaster or emergency as proclaimed by the Governor or by concurrent resolution by the Legislature or the President of the United States, whichever occurs first. This language could be problematic in the absence of a declaration of termination for a declared disaster because the termination of a declared disaster is rarely proclaimed.

[5] Government Code §8629.

This bill uses the sales tax term “qualified person” in the PITL and CTL provisions. “Qualified taxpayer" is the customary term used within a franchise or income tax statute and has the benefit of past usage and common understanding within the Revenue and Taxation Code. It is recommended that the PITL and CTL provisions be amended to reference terms as defined for franchise and income tax purposes.

LPs, LLPs, and LLCs (not treated as corporations) are included in the definition of “qualified person” yet none of these entities are subject to an income tax and the bill fails to address whether the exclusion would apply to these entities' owners. For ease of administration, it is recommended that the bill be amended to clarify how the exclusion would affect the owners of LPs, LLPs, and LLCs (not treated as corporations).

A "qualified person" would mean a specified business entity that (1) was not "doing business" in California prior to commencement date of the declared state disaster or emergency, and (2) is "doing business" in California after the commencement date of the declared state disaster or emergency upon the request of a registered business or by a state agency or a local agency, for the purpose of performing disaster- or emergency-related work. Some of this language is ambiguous and leads to the following questions:

- Is the "commencement date" different than the date of declaration?
- How long is "prior to commencement date"? For example, if a business entity was "doing business" in California ten years prior to the disaster or emergency period, but then had not been "doing business" for the previous seven years, would the business entity be eligible for the exclusion of income for a currently declared disaster or emergency?
- How long is "after the commencement date"? As written, if a business entity comes in to help with the disaster, it appears that it could then continue to do business here for non-disaster related projects and the income would remain excluded.

The author may wish to clarify the language under the "qualified person" definition to reduce confusion.

The "qualified person" would be required to be "doing business" upon the request of a registered business, state agency, or a local agency. The term "request" is undefined. The absence of the meaning to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this exclusion.

“Registered business” would mean a business entity that is registered to do business in this state prior to the commencement date of the declared state disaster or emergency. The phrase "registered to do business" applies to a foreign business entity transacting intrastate business under the California Corporations Code. Therefore, a domestic business entity (created, incorporated, or formed under the laws of California) would not be included under "registered business". If this is contrary to the author's intent, the language should be amended.

Because the bill fails to specify otherwise, the individual workers would still be taxable by California on wages earned while working here, and the employer would be subject to the Employment Development Department requirements as an employer. If this is contrary to the author’s intent, the bill should be amended.

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.

Although not contained in tax law, the New York State Department of Taxation and Finance adopted a policy with respect to businesses and individuals present in New York State on a temporary basis as a result of Hurricane Sandy. Under this policy, corporate franchise taxes, withholding taxes, personal income taxes, penalties or interest related to those taxes were waived when businesses and individuals earn income related to Hurricane Sandy relief efforts. *New York's* policy does not apply to sales tax.

Review of *Florida, Illinois, Massachusetts, Michigan*, and *Minnesota* laws found no comparable income exclusion.

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 and the implementation concerns are resolved, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

The revenue impact of this bill depends on the number, type and magnitude of declared state disasters or emergencies that occur in California, the amounts received by a qualified person for performing disaster- or emergency-related work during the specified disaster period that is excluded from income, and the associated deductions.

Developing estimates of this sort is highly speculative due to inherent uncertainties, (e.g. predicting the type, magnitude, and frequency of future natural and man-made disasters) as well as the income characteristics of qualified persons using this exclusion.

It is estimated that for every $100 million in qualifying payments made to qualified persons not doing business in the state prior to the disaster, there would be a revenue loss of approximately $1.2 million.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Supporters may argue that out-of-state business entities should be encouraged to perform disaster- or emergency-related work in California by the relief of taxes on those activities.

Opponents: Some may say that providing preferential tax treatment to out-of-state business entities that perform disaster- or emergency-related work in California would be damaging to the success of in-state business entities.

POLICY CONCERNS

While this bill would provide for an exclusion of income for certain LLCs, LPs, LLPs, and corporations if they meet the specified activity criteria, other business entities such as sole proprietorships that meet the same activity criteria would still have to include the income in their taxable base. Thus, this bill would provide differing tax treatment to taxpayers based solely on their classification or form of organization.

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