

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Brulte Analyst: Roger Lackey Bill Number: SB 40

Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 12-07-98

Attorney: Doug Bramhall Sponsor: _____

SUBJECT: Eliminate Minimum Franchise Tax

SUMMARY

This bill would repeal the minimum franchise tax and the prepayment to the Secretary of State (SOS).

In addition, this bill would modify the General Fund revenue forecast calculated by the Department of Finance (DOF) by providing that the revenue reduction from repealing the minimum franchise tax and the prepayment to the SOS would not impact the trigger that would initiate additional reductions in the motor vehicle license fee. This analysis will not address the bill's changes to General Fund revenue forecasts, as this provision does not impact the Franchise Tax Board.

EFFECTIVE DATE

This bill would be effective for income years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 10, AB 19, SB 42 (1999), AB 2798 (Stats. 1998, Ch. 323), AB 27 (1998), SB 842 (1997), SB 510 (1997), AB 8 (1997), AB 27 (1997), SB 38 (Stats. 1996, Ch. 954), AB 546, AB 3298, AB 3010, AB 3394 (1996); AB 647, AB 744, AB 1098 (1995); AB 411, AB 977, AB 1721, AB 2886, AB 3807 (1993/94); AB 3506, SB 1453 (1992); AB 4275 (1989/90); SB 572 (Stats. 1987, Ch. 1139); AB 1 (Stats. 1971, Ch.1); AB 1175 (Stats. 1957, Ch. 1127).

PROGRAM HISTORY/BACKGROUND

The minimum franchise tax was established to ensure that all corporations pay at least a minimum amount of franchise tax for the privilege of doing business in this state, regardless of the corporation's level of income (or loss). The minimum franchise tax has varied over the years. For income years ending before June 25, 1959, the minimum franchise tax is \$25. For income years ending after June 25, 1959, and beginning before January 1, 1972, the minimum franchise tax is \$100. For income years beginning after December 31, 1971, and before January 1, 1987, the minimum franchise tax is \$200. For income years beginning after December 31, 1986, and before January 1, 1989, the minimum franchise tax is \$300 (SB 572, Stats. 1987, Ch. 1139). This tax was increased to \$600 for income years beginning on or after January 1, 1989, and before January 1, 1990, and to \$800 for income years beginning on or after January 1, 1990. Beginning on January 1, 1999, a "qualified new corporation," as defined, pays a \$500 minimum franchise tax for its second taxable year. The minimum franchise tax is \$25 for certain gold and quicksilver mining corporations. Credit unions, certain nonprofit cooperative associations, and exempt organizations are not subject to the minimum franchise tax.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Gerald Goldberg

1-28-99

Corporations prepay the minimum franchise tax to the Secretary of State (SOS) at the time they incorporate (California corporation) or initially qualify (non-California corporation) with that office to do business in this state. This initial payment constitutes the taxpayer's initial franchise tax return. For income years beginning on or after January 1, 1997, and before January 1, 1999, the prepayment to the SOS is reduced to \$600 for a "qualified new corporation," as defined. For income years commencing on or after January 1, 1999, the prepayment to the SOS for a "qualified new corporation," definition revised, is reduced to \$300. If a non-California corporation commences to do business in this state without qualifying with the SOS, the FTB assesses the initial minimum franchise tax.

SPECIFIC FINDINGS

Under existing 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 income 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 \times 8.84\% = \799).

Existing state law provides that real estate mortgage investment conduits (REMICs) are subject to and required to pay the minimum franchise tax. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations also are subject to and required to pay the minimum franchise tax.

Under existing state law, the tax on limited partnerships (LPs), limited liability companies (LLCs), and limited liability partnerships (LLPs) is set at \$800 by reference to the amount provided in the minimum franchise tax statute.

Existing state law provides for income years commencing on or after January 1, 1997, and before January 1, 1999, a reduced prepayment of tax to the SOS of \$600 for a "qualified new corporation" with gross receipts, less returns and allowances, reportable to this state of less than \$1 million. The reduced tax applies only to the prepayment payable to the SOS in connection with incorporation or registration with the SOS.

For income years beginning on or after January 1, 1999, the prepayment to the SOS for the first income year of a "qualified new corporation" is \$300, and the minimum franchise tax for its second taxable year is \$500. A "qualified new corporation" does not include any corporation that began business operations as a single proprietorship, a partnership, or any other form of business entity prior to its incorporation. To be eligible for the reduced prepayment and minimum franchise tax, the qualified new corporation must be incorporated on or after January 1, 1999.

Also, **existing state law** provides that the determination of whether a corporation meets the gross receipts criterion is based on the aggregate gross receipts of the members of a commonly controlled group. The law defines "gross receipts less returns and allowances reportable to this state" as including both business and non-business receipts.

The reduced minimum franchise tax does not apply to any corporation if 50% or more of its stock is owned by another corporation. In addition, it does not apply to certain entities such as limited partnerships, limited liability companies, and charitable corporations required to pay the minimum franchise tax as a result of failure to file with the Attorney General.

For income years beginning on or after January 1, 1997, and before January 1, 1999, a corporation that paid \$600 to the SOS must pay an additional tax of \$200 on the due date of its first return, without regard to extension, if its gross receipts exceed \$1 million or its tax liability exceeds \$800. For income years beginning on or after January 1, 1999, a corporation that paid \$300 to the SOS must pay an additional \$500 if it does not meet the requirements of a "qualified new corporation," in its first income year, and if it paid \$500 minimum franchise tax for its second taxable year, the corporation must pay an additional \$300 if it fails to meet the requirements in its second taxable year.

This bill would repeal Section 23153 of the Revenue and Taxation Code and eliminate the minimum franchise tax, including the \$25 tax for gold and quicksilver mining corporations and the reduced \$500 tax for qualified new corporations.

In addition, by repealing Section 23153 this bill in effect would extinguish the annual fee paid by limited liability companies, limited liability partnerships, limited partnerships, etc. that, by reference to Section 23153, owe an amount equal to the minimum franchise tax (\$800).

This bill would repeal Section 23221 of the Revenue and Taxation Code and eliminate the prepayment of the minimum franchise tax to the SOS, including the reduced \$300 prepayment for qualified new corporations.

Policy Consideration

It is unclear if the author intended to eliminate the annual payment for those entities whose annual fee is set by reference to the minimum franchise tax section (Sec. 23153).

Implementation Considerations

The department's current programs and operations are established to accept the minimum franchise tax payments. While eliminating the tax entirely would eliminate a workload, the initial implementation would require significant program changes.

Because repealing the minimum franchise tax and the prepayment to the SOS would apply to income years beginning on or after January 1, 1999, refunds would need to be made to any banks or corporations that prepaid the minimum franchise tax to the SOS or have already paid the minimum franchise tax. Processing refunds would be a minor impact to the department.

Technical Considerations

There are numerous cross references throughout the Revenue and Taxation Code to the minimum franchise tax under Section 23153. For example, provisions related to the estimated tax obligations of corporations require that the first installment of estimated tax be for an amount no less than the minimum franchise tax under Section 23153. Conforming amendments should be made to each of these provisions to eliminate these references.

FISCAL IMPACT

Departmental Costs

Departmental costs to reprogram existing systems could be significant and are currently being determined. However, long-term savings should result from eliminating the minimum franchise tax workload.

Tax Revenue Estimate

Revenue losses are estimated as follows:

Effective for Income Years Beginning January 1, 1999 Enactment Assumed After June 30, 1999 (in millions)		
1999-0	2000-1	2001-2
(\$515)	(\$350)	(\$360)

The estimate for the first fiscal year above includes the impact of minimum tax and Secretary of State fee due dates within the 18 month time period. Approximately 80% of the annual impact is for corporations.

Revenue Discussion

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue losses would depend on the number of corporations (including limited partnerships and limited liability companies) subject to the minimum tax each year.

It is projected that for income years beginning in 1999, approximately 400,000 corporations (including subsidiaries) and approximately 85,000 limited partnerships and limited liability companies would benefit from the minimum tax repeal. Estimates above also include the repeal of the Secretary of State fee at the time of incorporating for approximately 55,000 new corporations each year.

BOARD POSITION

Pending.