Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Allen, et al.	Analyst:	Jessica Deitchman	Bill Number:	AB 2544
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	May 12, 2016
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: LLCs/Qualified Investment Partnerships File Return as Partnership

SUMMARY

This bill would, under the Personal Income Tax Law, provide a temporary exemption for certain Limited Liability Companies (LLC) from the annual tax and fee.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The May 12, 2016, amendments modified the operative date of the bill. Except for the "This Bill," and "Effective/Operative Date," sections, the department's analysis of the bill as introduced February 19, 2016, still applies. The "Fiscal Impact," "Economic Impact," and "Policy Concern" sections have been restated for convenience.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2016, and before January 1, 2020.

THIS BILL

For taxable years beginning before January 1, 2020, this bill would provide an exemption from the annual tax and fee for LLCs that are classified as qualified investment partnerships.

"Qualified investment partnership" would mean an LLC that meets all of the following requirements:

- The LLC is classified as a partnership for California income tax purposes.
- No less than 90 percent of the costs of its total assets consist of qualifying investment securities, deposits at banks or other financial institutions, interest or investments in a partnership, or office space and equipment reasonably necessary to carry on its activities as a qualified investment partnership.
- No less than 90 percent of its gross income consists of interests, dividends, and gains from the sale or exchange of qualifying investment securities or investments in a partnership.

"Qualifying investment securities" would have the same meaning as that term is described in Section 17955 (c)(3)(A)[1] of the Revenue and Taxation Code (R&TC).

Additionally, this bill would require:

- A qualified investment partnership that is required to file a federal return,[2] to file a state partnership return[3] for that taxable year.
- A qualified investment partnership that is not required to file a federal return,[4] to file an information return as prescribed by the Franchise Tax Board (FTB) for that taxable year.

FISCAL IMPACT

Department staff have not yet determined the costs to administer this bill. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2544 As Amended May 12, 2016 Assumed Enactment After June 30, 2016 ($ in Millions)		
2016-17	2017-18	2018-19
- $1.7	- $1.8	- $1.9

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

Revenue Discussion:

The revenue impact would consist of the following: the revenue loss due to the annual tax exemption of $800 per LLC, the revenue loss due to the LLC fee exemption, and the revenue gain from LLC fees that would no longer be deducted at the individual taxpayer level.

[1] R&TC section 17955(c)(3)(A) provides a list of securities that are considered "qualified investment securities," which include securities such as common stock, bonds, foreign and domestic currency deposits, and repurchase agreements.
[2] Pursuant to Section 6031 of the Internal Revenue Code (IRC).
[3] Pursuant to Section 18633 of the R&TC.
[4] Pursuant to Section 6031 of the IRC.

Based on FTB data, there were approximately 5,300 LLCs that were holding companies in California in 2015. For purposes of this estimate, it was assumed that 20 percent of these LLCs would qualify and be exempt from tax. Based on the FTB's historical tax filing data, it was assumed that the number of qualifying LLCs would increase at the rate of 6 percent per year. This would result in a revenue loss of approximately $900,000 in 2016 ($800 x 1,120).

The fee portion of the revenue impact was estimated using the percentages of qualifying LLCs at each fee level based upon 2015 tax data, resulting in a revenue loss of approximately $800,000. Because the LLC fee would no longer be a deduction from tax liabilities at the individual level and assuming an average individual tax rate of 5 percent, the estimated offsetting revenue gain would be approximately $40,000. After rounding, this bill would result in a total estimated loss for 2016 of $1.7 million.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

SUPPORT/OPPOSITION[5]

Support: Angel Capital Association; National Federation of Independent Business (NFIB); San Jose Silicon Valley Chamber of Commerce; Arthur Korteweg, Associate Professor of Finance at Stanford University School of Business; Dr. Shai Bernstein, Assistant Professor of Finance at Stanford Graduate School of Business; Dave McClure, 500 Startups Founder; Naval Ravikant, CEO AngelList.

Opposition: None provided.

POLICY CONCERNS

This bill would provide a tax benefit for certain types of LLCs that would be unavailable to other types of business entities. Thus, this bill would provide differing treatment based solely on business type.

LEGISLATIVE STAFF CONTACT

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[5] As indicated on author provided fact sheet.