Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Patterson	Analyst:	Jessica Deitchman	Bill Number:	AB 612
Related Bills:	See Legislative History	Telephone:	845-6310	Amended Date:	March 12, 2015
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Minimum or Annual Franchise Tax/$400 for New Small Business Corporation, Limited Partnership, Limited Liability Partnership, & Limited Liability Company

SUMMARY

This bill would, under the Corporation Tax Law (CTL) and Personal Income Tax Law (PITL), reduce the minimum franchise or annual tax for certain new, small business entities.

RECOMMENDATION

No position.

Summary of Amendments

The March 12, 2015, amendments removed provisions of the bill related to alternative minimum tax, and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

Summary of Suggested Amendments

Technical amendments are provided to correct an obsolete reference and a cross referencing error.

REASON FOR THE BILL

The reason for this bill is to provide tax relief for new, small businesses doing business in California, by reducing the minimum or annual tax for the first or second taxable year.

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, 2016.

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

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corporate 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).

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 (LP); limited liability companies (LLC) not classified as corporations, limited liability partnerships (LLP), 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 LPs, LLCs not classified as corporations, and LLPs 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.

THIS BILL

For taxable years beginning on or after January 1, 2016, this bill would reduce the minimum franchise or annual tax, as applicable, to $400 as follows:

- For the first taxable year of a new LP, new LLP, or new LLC, provided that it was a small business for its first taxable year (annual tax).
- For the second taxable year of a new corporation, provided that the entity is a small business in both of its first two taxable years (minimum franchise tax).

This bill would define the following terms:

- “New LP, LLP, LLC or new corporation” means an LP, LLP, LLC, or corporation that on or after January 1, 2016 is organized under the laws of the state or qualified to transact intrastate business in the state and begins business operations at or after the time of its organization.
- “Small Business” means either:
    - An LP or LLP, that has gross receipts, less returns and allowances, reportable to this state for the taxable year of $5,000 or less, or
    - An LLC or corporation that reasonably estimates that it will have gross receipts, less returns and allowances, reportable to this state for the taxable year of $5,000 or less.

- "Gross receipts, less returns and allowances reportable to this state," means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of Section 25120[1] and the gross receipts from the production of non-business income, as defined in subdivision (d) of Section 25120.[2]

The reduction of the minimum franchise or annual tax would be unavailable to any new LP, LLC, LLP or corporation that either; began business operations, or acquired its business operations as follows:

- New LP: from a sole proprietorship, LLC, general partnership, corporation, or any other business entity prior to its organization or that acquired its business operations from a partnership.
- New LLC: from a sole proprietorship, a partnership, a corporation, or any other form of business entity prior to its organization or that acquired its business operations from an LLC.
- New LLP: from a sole proprietorship, an LLC, a corporation, a partnership, or any other form of business entity prior to its organization or that acquired its business operations from an LLP.
- New corporation: from a sole proprietorship, a partnership, LLC, or any other form of business entity prior to its incorporation or that acquired its business operations from a corporation.

The reduction would be unavailable to any LP, LLC, LLP or corporation that reorganized solely for the purpose of reducing its minimum tax.

To receive the reduction of the minimum franchise or annual tax, the LP, LLP, LLC or corporation must file a timely return, without regard to extension for that year.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concern. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

An LP, LLP, LLC or corporation that organized prior to the effective date of this bill that meets the definition of a "new LP, LLP, LLC or corporation" would qualify for a reduced minimum franchise tax, therefore, existing business entities, not just new business entities, could qualify for this bill's exemption. If this is contrary to the author's intent, this bill should be amended.

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[1] "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

[2] "Nonbusiness income" means all income other than business income.

TECHNICAL CONSIDERATIONS

The references to the Corporations Code sections in current law, 15623 and 15696 are obsolete and should be deleted.

To correct a cross reference, the following amendments should be made:

On page 6, line 35, after “gross receipts” insert: “less returns and allowances reportable to this state”.

On page 11, line 36, after “gross receipts” insert: “less returns and allowances reportable to this state”.

LEGISLATIVE HISTORY

AB 328 (Grove, 2015/2016) would eliminate the minimum franchise tax or annual tax for new veteran-owned small corporations and LLCs, as specified. AB 328 is pending before the Assembly Revenue and Taxation Committee.

AB 1769 (Dababneh, 2013/2014) would have exempted certain small business LLCs from the minimum franchise tax for up to two taxable years. AB 1769 failed passage out of the Assembly by the constitutional deadline.

AB 1889 (Hagman, 2013/2014) substantially similar to this bill, would have exempted certain small business entities from the minimum franchise tax for up to the first two taxable years. AB 1889 failed passage out of the Assembly by the constitutional deadline.

AB 2428 (Patterson, 2013/2014) would have eliminated the minimum franchise tax for new business entities for up to five taxable years. AB 2428 failed passage out of the Assembly by the constitutional deadline.

AB 2466 (Nestande, et al., 2013/2014) would have reduced or eliminated the annual fee or minimum franchise tax for certain veteran-owned small business LLCs and corporations. AB 2466 failed passage out of the Assembly by the constitutional deadline.

AB 2495 (Melendez, 2013/2014) would have eliminated the minimum franchise tax for new business entities for up to five taxable years. AB 2495 failed passage out of the Assembly by the constitutional deadline.

SB 641 (Anderson, 2013/2014) would have eliminated the minimum franchise tax for certain new corporations for the first four taxable years. SB 641 failed passage out of the Senate by the constitutional deadline.

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.

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, *Massachusetts*, and *New York* do impose a minimum tax on corporations, but they lack an exemption similar to the one proposed in this bill.

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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 612* As Amended March 12, 2015 Assumed Enactment After June 30, 2015 ($ in Millions)		
2015-16	2016-17	2017-18
- $4	- $9.8	- $13

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

Revenue Discussion

This estimate assumes the bill is amended to address the implementation concern regarding newly formed business entities.

Based on new business registration data from the Secretary of State for years 2009-2014, it is estimated that there will be 13,000 new corporations and 17,000 new LLCs, LLPs, and LPs (business entities subject to the PITL) that would benefit from this bill in 2016. For each eligible entity the reduced minimum tax will cost the state general fund $400. Because corporations are already exempt from the minimum franchise tax in their first year there is no impact for corporations in the first year, however the bill provides the $400 reduction in year two. The estimated revenue loss for 2016, for PIT entities, is $6.8 million. In 2017 when both corporate and PIT entities are eligible, the estimated revenue loss is $12.8 million. The tax year estimate are converted to fiscal years and rounded to arrive at the amounts reflected in the table above.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the bill would give a needed tax reduction to small businesses in California and therefore encourage them to stay in business.

Opponents: Some may argue that providing a reduction to newly formed business entities may be overly narrow and inadvertently exclude other businesses that may also be struggling.

POLICY CONCERNS

This bill would provide a tax benefit for business entities subject to the CTL that is not provided for those subject to the PITL. Thus, this bill would provide differing treatment based solely on business organization.

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