

ANALYSIS OF AMENDED BILL

Author: Steinorth Analyst: Janet Jennings Bill Number: AB 1016
Related Bills: See Legislative History Telephone: 845-3495 Amended Date: March 29, 2017
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Annual Tax/Prorate for New Limited Liability Company

SUMMARY

This bill would prorate the annual tax for a new limited liability company (LLC).

RECOMMENDATION – NO POSITION

Summary of Amendments

The March 29, 2017, amendments removed provisions related to the Corporations Code and replaced them with the provisions discussed in this analysis. This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for the bill is to encourage LLCs to begin business operations earlier.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for specified LLCs that first organize or register on or after January 1, 2018.

FEDERAL LAW

Federal law has no annual tax on LLCs comparable to the California annual tax.

STATE LAW

State law currently requires LLCs not classified as corporations that are organized, registered, or doing business in the state to pay an annual tax, in an amount equal to the minimum franchise tax, which is currently \$800. Every LLC subject to the annual tax is also required to pay an annual fee based on the total income from all sources derived from or attributable to the state.

The fee is determined as follows:

- If total income is more than \$250,000, but less than \$500,000, the fee is \$900.
- If total income is more than \$500,000, but less than \$1 million, the fee is \$2,500.
- If total income is more than \$1 million, but less than \$5 million, the fee is \$6,000.
- If total income is more than \$5 million, the fee is \$11,790.

The fee must be estimated and paid no later than the 15th day of the 6th month of the taxable year. A penalty of 10 percent of the amount of underpayment will be added to any fee paid late.

Doing Business

Revenue & Taxation Code (R&TC) section 23101 at subsection (a) defines "doing business" as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit. Furthermore, subsection (b) of R&TC section 23101 provides that 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 (e) or (f) of R&TC section 25120, of the taxpayer in California, including sales by the taxpayer's agents and independent contractors, exceed the lesser of \$547,711 for 2016, or 25 percent of the taxpayer's total sales, as specified,
- Real property and tangible personal property of the taxpayer in California exceed the lesser of \$547,711 for 2016, or 25 percent of the taxpayer's total real and tangible personal property as specified, or
- The amount paid in California by the taxpayer for compensation, as defined in subdivision (c) of R&TC section 25120, exceeds the lesser of \$54,711 for 2016, or 25 percent of the total compensation paid by the taxpayer, as specified.

THIS BILL

This bill would, for taxable years beginning on or after January 1, 2018, require a new LLC to pay an annual tax depending upon the calendar year quarter in which the LLC files the articles of organization, as follows:

- January 1 through March 31, eight hundred dollars (\$800).
- April 1 through June 30, six hundred dollars (\$600).
- July 1 through September 30, four hundred dollars (\$400).
- October 1 through December 31, two hundred dollars (\$200).

The bill would define a new LLC as an LLC that on or after January 1, 2018, is organized under the laws of this state or has qualified to transact intrastate business in this state that begins business operations at or after the time of its organization.

The bill specifies that a new LLC would not include any LLC that began business operations as, or acquired its business operations from, a sole proprietorship, an LLC, or any other form of business entity prior to its organization.

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.

This bill would allow new LLCs that elect a fiscal year to pay less tax than calendar year LLCs. If that is contrary to the author's intent, the bill should be amended. Also, the bill should be amended to account for fiscal-year filers.

It is unclear whether this bill's provisions prorating the annual tax or the provisions allowing a waiver of or exclusion from the annual tax would be controlling for an LLC that would otherwise be eligible for such a waiver or exclusion.¹

TECHNICAL CONSIDERATIONS

To clarify a new LLC would be ineligible for the prorated minimum tax if it previously was doing business, the bill should be amended as follows:

On page 4, line 19, delete "operations" and insert "assets"

On page 4, line 21, delete "prior to its organization." and insert "that began doing business as defined in section 23101 prior to its qualification to transact intrastate business in this state."

LEGISLATIVE HISTORY

AB 1256 (Brough, 2017/2018) would, under the Personal Income Tax Law and the Corporations Tax Law, reduce the minimum franchise or annual tax for new entities in California. AB 1256 has been referred to the Assembly Revenue and Taxation Committee.

AB 1432 (Melendez, 2017/2018) would eliminate the minimum franchise tax for every new corporation for the first five taxable years. AB 1432 was introduced on February 17, 2017.

SB 248 (Morrell, 2017/2018) would eliminate the annual tax for the first taxable year and reduce the minimum franchise or annual tax to \$400 for new, small business corporations, LLCs, Limited Liability Partnerships (LLPs), and Limited Partnerships (LPs). SB 248 was introduced on February 7, 2017.

AB 328 (Grove, 2015/2016) would have eliminated the minimum franchise tax or annual tax for new veteran-owned small corporations and LLCs. AB 328 failed passage out of the Assembly by the constitutional deadline.

¹ R&TC sections 17946 and 17947.

AB 612 (Patterson, 2015/2016) would have reduced the annual tax to \$400 for new, small business LLCs, LLPs, and LPs. AB 612 failed passage out of the Assembly by the constitutional deadline.

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 from the Assembly Revenue and Taxation Committee.

AB 1889 (Hagman, Chapter 700, Statutes of 2014) exempted certain small business entities from the minimum franchise tax for up to the first two taxable years.

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 from the Assembly Revenue and Taxation Committee.

AB 2466 (Nestande, 2013/2014) would have exempted, in total or in part, certain small, veteran-owned business entities from the minimum franchise tax. AB 2466 failed passage from the Assembly Appropriations Committee.

AB 2495 (Melendez, 2013/2014) was substantially similar to this bill. AB 2495 failed passage from the Assembly Revenue and Taxation Committee.

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 from 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.

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 LLCs, LLPs, and LPs 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

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1016 As Amended March 29, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$7.5	- \$14	- \$15

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

Revenue Discussion

Based on new business registration data from the Secretary of State and data from the Franchise Tax Board for years 2009-2016, it is estimated that in 2018 approximately 45,000 new LLCs would register and be doing business per the limitations specified in the bill. Approximately 32,000 taxpayers would be subject to the annual tax and benefit from the reduced tax in tax year 2018, resulting in an estimated loss of \$13 million.

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

SUPPORT/OPPOSITION

Support: None on file.

Opposition: None on file.

ARGUMENTS

Proponents: Some taxpayers may argue that providing a prorated minimum tax would give a needed tax break to newly formed LLCs would encourage them to start business operations earlier.

Opponents: Some taxpayers may argue that providing a prorated minimum tax to only newly formed LLCs may be overly narrow and inadvertently exclude other businesses that also need assistance.

POLICY CONCERN

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the tax incentive by the Legislature.

LEGISLATIVE STAFF CONTACT

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