

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Calderon Analyst: Janet Jennings Bill Number: AB 1085
Related Bills: See Legislative History Telephone: 845-3495 Introduced Date: February 16, 2017
Attorney: Bruce Langston Sponsor: _____

SUBJECT: Minimum Franchise & Annual Tax/Authorize Payment in 2 or 3 Equal Installments

SUMMARY

This bill would allow corporations and Limited Liability Companies (LLCs) the option to pay their minimum franchise or annual tax in 2 or 3 equal installments.

RECOMMENDATION – NO POSITION

REASON FOR THE BILL

The reason for the bill is to provide corporations and LLCs the option to pay the minimum franchise tax or annual tax, as applicable, in installments.

EFFECTIVE/OPERATIVE DATE

If enacted in the 2017 legislative session, this bill would be effective January 1, 2018, and specifically operative on and after that date.

FEDERAL LAW

Under federal law, all corporations are required to file an annual tax return whether or not they have taxable income. Corporations with taxable income are taxed at graduated tax rates that vary from 15 percent to 35 percent.

Federal law has no minimum franchise tax on business entities comparable to the California minimum franchise or annual tax.

In general, federal law requires corporations to make estimated tax payments if the corporation expects to owe \$500 or more in tax. Estimated taxes are due in four equal installments of 25 percent each.

Additionally, federal law requires that an LLC with more than two members be classified as a partnership for federal tax purposes unless it specifically elects to file as a corporation. Federal law has no requirement for partnerships to pay an annual fee or minimum 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, 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 must be estimated and paid no later than the 6th month of the taxable year. A penalty of 10 percent of the amount of underpayment is added to any fee paid late.

In general, taxes are due on income as it is earned. If the income is not subject to withholding, individual and corporate taxpayers are required to remit estimated tax payments. If a corporation's estimated tax does not exceed the minimum franchise tax, the entire amount of the minimum franchise tax is payable as the 1st estimated tax payment. If the amount of estimated tax exceeds the minimum franchise tax the corporation's estimated tax payments are remitted quarterly as 30 percent, 40 percent, 0 percent, and 30 percent of the required annual payment, this is referred to as the regular method.

Failure to pay a required estimated payment will subject a taxpayer to a penalty for any underpayment of estimated tax. The underpayment rate is the same as the interest rate charged for tax delinquencies. The penalty is calculated by comparing the required amount for each estimated tax payment, determined under either the regular method, as discussed above, or the "annualized income installment method." Corporations not required to make an estimated tax payment for the first quarter are required to make estimated tax payments of 60 percent, 0 percent, and 40 percent for the 2nd, 3rd, and 4th quarter installments, respectively. Corporations not required to make an estimated tax payment for the first and second quarter are required to make estimated tax payments of 70 percent, and 30 percent, for the 3rd, and 4th quarter installments, respectively.

Current California law provides that interest is charged on underpayments of tax from the last day prescribed for payment to the date the payment is made. The last day prescribed for payment is the date the tax liability arises, not later than the date the notice and demand is made by the Franchise Tax Board (FTB). This generally is the due date of the tax return, without regard to extension.

Current state law imposes penalties when a taxpayer fails to file a tax return on or before its due date or fails to pay the tax due as shown on their tax return by the due date of the return.

THIS BILL

This bill would replace the specified due date for the LLC annual tax and corporation estimate tax of the minimum franchise tax only, with the following three payment options:

- Payment in full due on or before the 15th day of the fourth month of the taxable year,
- In three equal installments due on or before the 15th day of the 4th, 8th, and 12th months of the taxable year, or
- In two equal installments, with the first installment due on or before the 15th day of the fourth month of the taxable year and the second installment due on or before 12 months of that date.

No penalties or interest would be imposed on a taxpayer for electing to use an alternative payment option.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The bill lacks a process for a taxpayer to select a payment option and report that selection in advance of the installment due dates to the FTB. Generally, a taxpayer is required to make a binding election each tax year to provide certainty for both the taxpayer and the department. For example, absent a provision requiring a binding election, taxpayers could select a different payment option during the tax year to avoid penalties or interest. For clarity and ease of administration, this bill should be amended.

Although the bill language states that no penalties or interest would be assessed based on an election to use an alternative payment option, because the general penalty and interest provisions are unchanged and are controlling, a taxpayer that made payments as described in one of the payment options would remain subject to interest and penalties for late payments. To ensure consistency with the author's intent, this bill should be amended.

TECHNICAL CONSIDERATIONS

The bill uses the phrase, "and the second installment on or before 12 months of that date" which is not clearly worded. The author may want to amend the bill to change the phrase to "and the second installment on or before 12 months after the date of the first installment," which may be less confusing.

This bill uses the undefined terms "payment option" and "alternative payment option" interchangeably. It is recommended that the bill be amended to consistently use the term "alternative payment option."

LEGISLATIVE HISTORY

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, 2013/2014) would have exempted certain small business entities from the minimum franchise tax for up to the first two taxable years. AB 1889 failed passage from the Assembly Revenue and Taxation Committee.

AB 2086 (Calderon, 2013/2014) would have replaced the specified due date for the LLC fee and annual tax, and corporation minimum franchise tax, with three payment options. AB 2086 failed passage the Assembly Revenue and Taxation Committee.

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 either exempted or reduced certain, veteran owned small business entities from the minimum franchise tax. AB 2466 failed passage from the Assembly Appropriations Committee.

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 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.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York* laws found no comparable alternative payment schedule similar to the alternative this bill would establish. These states were selected and reviewed due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

The department's costs to administer this bill are unable to be determined until the implementation concerns have been resolved. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

The impact to the general fund revenues are unable to be estimated until the implementation concerns have been resolved. For example, the due date of taxes, and effective application dates for penalties, and interest are uncertain.

SUPPORT/OPPOSITION

Support: None on file.

Opposition: None on file.

ARGUMENTS

Proponents: Some may argue that the bill would allow corporations and LLCs flexibility in the timing of tax and fee payments, reducing the burden of making a large one-time payment.

Opponents: Some may argue that this alternative payment schedule increases the already difficult-to-estimate cash flow to the general fund and may be viewed as an unfair practice by taxpayers not afforded this flexibility.

POLICY CONCERN

This bill would provide a tax benefit for corporations and LLCs that would not be provided to other business types treating similarly situated taxpayers differently based on the business entity's classification.

LEGISLATIVE STAFF CONTACT

Janet Jennings
Legislative Analyst, FTB
(916) 845-3495
janet.jennings@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov