

Author: Brough Analyst: Jessica Deitchman Bill Number: AB 1256  
Related Bills: See Prior Telephone: 845-6310 Amended Date May 16, 2017  
Analysis Attorney: Bruce Langston Sponsor: \_\_\_\_\_

**SUBJECT:** Minimum Franchise and Annual Tax/Reduce to \$100 for 1<sup>st</sup> or 2<sup>nd</sup> Taxable Year

## **SUMMARY**

This bill would, under the Personal Income Tax Law and the Corporation Tax Law, reduce the minimum franchise or annual tax for certain new entities in California.

## **RECOMMENDATION – NO POSITION**

## **SUMMARY OF AMENDMENTS**

The May 16, 2017, amendments made technical changes and modified the operative date. As a result of the amendments, the technical considerations as provided in the department's analysis of the bill as introduced February 17, 2017, have been resolved and a new implementation consideration has been identified. Except for the "Effective/Operative Date," "This Bill," "Implementation Considerations," and "Technical Considerations," the remainder of that analysis still applies. The "Fiscal Impact" section has been restated for convenience and the "Economic Impact," and "Support/Opposition" sections have been updated.

## **EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for each taxable year beginning on or after January 1, 2018, and before January 1, 2023, contingent on a budget measure specifically appropriating funds to the Franchise Tax Board (FTB) for costs to administer the bill's provisions.

## **THIS BILL**

For taxable years beginning on or after January 1, 2018 and before January 1, 2023, contingent on a budget measure specifically appropriating funds to the FTB for costs to administer the bill's provisions, this bill would allow every:

- New Limited Liability Company (LLC), Limited Liability Partnership (LLP), and Limited Partnership (LP) that is a small business to pay an annual tax of \$100 for its first taxable year.
- New corporation that is a small business to pay a minimum franchise tax of \$100 for its second taxable year.

The bill provides the following definitions:

- “New Limited Liability Company,” “New Limited Liability Partnership,” “New Partnership,” or “New Corporation” means an LLC, LLP, LP or corporation that on or after January 1, 2018, is first organized under the laws of this state or has first qualified to transact intrastate business in this state that begins business operations at or after the time of its organization. “New LLC, LLP, LP, or Corporation” does not include any LLC, LLP, LP or corporation that began business operations as, or acquired its business operations from, a sole proprietorship, an LLC, LLP, LP or corporation, or any other form of business entity prior to its organization.
- “Gross receipts, less return and allowances reportable to this state,” means the sum of the gross receipts from the production of business income,<sup>1</sup> and the gross receipts from the production of nonbusiness income.<sup>2</sup>
- “Small business” means an LLP or LP that has, or an LLC or corporation that reasonably estimates it will have, gross receipts, less returns and allowances, reportable to this state for the taxable year of \$5,000 or less. If the gross receipts, less returns and allowances, of an LLC or corporation for a taxable year exceeds \$5,000, an additional tax of \$100 is due and payable on the due date for the return, without regard to extension.

The bill states that the reduction would be unavailable to any LLC, LLP, LP or corporation that: (1) fails to file a return on the due date of its return, without regard to extension, for that year; or (2) that reorganizes solely for the purpose of reducing its annual tax.

## **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 LLC, LLP, LP or corporation that organized prior to the effective date of this bill that meets the definition of a “New LLC, LLP, LP 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.

The operative date language requires a budget appropriation, as specified, to trigger the reduced minimum franchise tax or annual tax. Because budget bills are generally enacted during June, and sometimes later, the amount of the minimum franchise and annual tax would be uncertain until that time. As a result, taxpayers whose minimum franchise or annual tax is due prior to the budget’s enactment (for example calendar year taxpayers that must pay by April 15<sup>th</sup>) would be required to pay the existing minimum tax to avoid being subject to penalties for late payment, and, if the reduced minimum amount is triggered would be required

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<sup>1</sup> As defined in Revenue and Taxation Code (R&TC) section 25120(a).

<sup>2</sup> As defined in R&TC section 25120(d).

to file a claim for refund for the difference between the amount paid and the reduced amount. For certainty and ease of administration it is recommended that the bill be amended to remove the appropriation language.

## **FISCAL IMPACT**

The department's costs to implement this bill have yet to be determined. As the bill moves 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 AB1256* As Amended May 16, 2017 Assumed Enactment After June 30, 2017 (\$ in Millions)		
2017-18	2018-19	2019-20
- \$14	- \$47	- \$70

\*Estimates assumes a specific appropriation of funds to the FTB would be enacted in 2018 and each year thereafter for its costs to administer the credit.

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 (SOS) and data from the FTB for years 2009-2016, it is estimated that in 2018 approximately 85,000 corporations, and 45,000 LLCs, LLPs, and LPs would register and be doing business per the limitations specified in the bill.

The estimated revenue loss for 2018 does not include corporations because they are not subject to the minimum franchise tax in their first year of operation under current law. However, approximately 35,000 LLCs, LPs and LLPs would be subject to the annual tax and benefit from the reduced tax in tax year 2018, resulting in an estimated revenue loss of \$25 million. For the 2019 tax year, it is estimated that 40,000 first year LLCs, LPs and LLPs and 60,000 second year corporations would benefit from the reduced minimum franchise tax and annual tax for a total estimated revenue loss of \$70 million.

This estimate includes an increase for existing LLCs, LLPs, LPs or corporations organized prior to the effective date of this bill as addressed in the implementation concern above.

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<sup>3</sup>**

Support: California Society of Enrolled Agents.

Opposition: California Tax Reform Association.

### **LEGISLATIVE STAFF CONTACT**

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<sup>3</sup> As provided in the Assembly Revenue and Taxation Committee analysis dated May 5, 2017.