



## Analysis of Original Bill

Author: Melendez	Sponsor:	Bill Number: AB 2131
Analyst: Janet Jennings	Phone: (916) 845-3495	Introduced: February 12, 2018
Attorney: Bruce Langston	Related Bills: See Legislative History	

**Subject:** Minimum Franchise Tax/Reduce to \$400

### Summary

The bill would under the Corporation Tax Law (CTL) reduce the Minimum Franchise Tax (MFT).

**Recommendation – No position.**

### Reason for the Bill

The reason for the bill is to provide relief to struggling businesses.

### 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, 2019.

### State Law

Under existing state law, unless specifically exempted by statute, every corporation organized, qualified to do business, or doing business in this state, whether organized in-state or out-of-state, is subject to the MFT. Corporate taxpayers must pay the MFT only if it is more than their measured franchise tax. In general, for taxable years beginning on or after January 1, 1997, only taxpayers subject to the CTL with net income less than approximately \$9,040 pay the MFT because the amount of “measured” tax owed would be less than \$800 ( $\$9,039 \times 8.84\% = \$799$ ).

Real estate mortgage investment conduits (REMICs) are subject to and required to pay the MFT. Regulated investment companies (RICs) and real estate investment trusts (REITs) organized as corporations are also subject to and required to pay the MFT.

Limited partnerships (LPs), limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), and qualified Subchapter S subsidiaries (QSubs) are required to pay an annual tax equal to the MFT, but are not subject to a “measured” income tax.

Every corporation that incorporates or qualifies to do business in this state is exempt from the MFT for the first taxable year of existence. This exemption is inapplicable to any corporation that reorganizes solely for the purpose of avoiding payment of the MFT. In addition, the first-year exemption is inapplicable to the annual taxes paid by LPs, LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, financial asset securitization investment trusts, or QSubs.

### **This Bill**

This bill would reduce the MFT from \$800 to \$400 for taxable years beginning on or after January 1, 2019, and make several technical changes.

### **Implementation Considerations**

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

Since other types of business entities reference the MFT to compute their annual tax, reducing the MFT provision would also have the effect of reducing the annual tax for such entities. The author may wish to amend the bill to specifically reduce only the corporate MFT, leaving the provision intact to preserve the existing cross-references.

### **Legislative History**

AB 1922 (Fong, et al., 2017/2018), among other things, would repeal the MFT. AB 1922 is pending hearing before the Assembly Revenue and Taxation Committee.

AB 990 (Conway, 2013/2014) would have reduced the MFT from \$800 to \$700. AB 990 failed passage out of the Assembly by the constitutional deadline.

AB 1889 (Hagman, et al., Chapter 700, Statutes of 2014) reduces the MFT for certain new business entities.

AB 2244 (Chau, 2013/2014) would have reduced the MFT or annual tax, whichever applies, for dormant and inactive business entities. AB 2244 failed passage out of the Assembly by the constitutional deadline.

AB 2428 (Patterson, 2013/2014) would have reduced the MFT and annual fees for business entities that incorporated or filed with the Secretary of State on or after January 1, 2014, for the first five taxable years. AB 2428 failed passage out of the Assembly Revenue and Taxation Committee.

AB 2466 (Nestande, 2013/2014) would have reduced the MFT to \$99 for new veteran-owned small business entities and would have eliminated the tax if the business entity operates at a loss or ceases operation. AB 2466 failed passage out of the Assembly Revenue and Taxation Committee.

AB 2495 (Melendez, 2013/2014) would have exempted certain new business entities from the MFT or annual fees for the first five consecutive taxable years. AB 2495 failed passage out of the Assembly Revenue and Taxation Committee.

SB 641 (Anderson, 2013/2014) would have exempted qualified new corporations from the MFT for its second, third and fourth taxable years. SB 641 failed passage out of the Senate by the constitutional deadline.

AB 166 (Cook, 2011/2012) would have eliminated the MFT. AB 166 failed passage out of the Assembly by the constitutional deadline.

AB 368 (Morrell, 2011/2012) would have reduced the MFT 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 MFT 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 MFT or annual tax and reduced the MFT 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 geographic proximity to California or 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 minimum tax of \$456 on corporations.

*New York* imposes a minimum tax on corporations of \$25 to \$200,000 based on the corporation's in-state receipts. *New York* also imposes a minimum tax of \$25 to \$4,500 for LPs, LLCs, and LLPs based on their in-state receipts.

### **Fiscal Impact**

Implementing this bill would require some changes to existing tax forms, related instructions, and information systems which could be accomplished during the normal annual update.

## **Economic Impact**

### **Revenue Estimate**

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2131 as Introduced February 12, 2018  
For Taxable Years Beginning On or After January 1, 2019  
Assumed Enactment after June 30, 2018, (\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$270
2019-2020	- \$600
2020-2021	- \$700

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or the net final payment method of accrual.

### **Revenue Discussion**

Based on data from the Franchise Tax Board for tax years 2012-2015, it is estimated that in taxable year 2019 approximately 700,000 corporations and 800,000 LLCs, LLPs, and LPs would be subject to the MFT under current law and would benefit from the reduction of the minimum tax to \$400.

The estimated revenue loss from the reduction of MFT to \$400 for C and S corporations would be approximately \$280 million in the 2019 taxable year. This consists of MFT that would no longer be paid offset by measured tax. C and S corporation taxpayers must pay the measured tax only if it is more MFT. The estimated revenue loss from the reduction of MFT to \$400 for LLCs, LPs, and LLPs would be approximately \$310 million.

This results in an overall loss of approximately \$590 million in the 2019 taxable year. The tax-year estimates are then converted to fiscal-years and rounded to arrive at the figures in the above table.

### **Support/Opposition**

Support: None Provided.

Opposition: None Provided.

## **Arguments**

Proponents: Some may argue that reducing the MFT would increase business activity in California.

Opponents: Some may argue that the current \$800 MFT is a small price to pay for the privilege afforded corporations that do business in California.

## **Legislative Staff Contact**

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