



Analysis of Original Bill

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Sponsor:

Bill Number: AB 2410

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Introduced: February 14, 2018

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Related Bills: See Legislative
History

Subject: Annual Tax/Reduce to \$400 for Limited Liability Company (LLC) Small Business within First 2 Years of Operation

Summary

This bill would, under the Personal Income Tax Law, reduce the annual tax for certain small business LLCs in California.

Recommendation – No position.

Reason for the Bill

The reason for this bill is to provide tax relief for small businesses by reducing the annual tax.

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, 2020.

Federal/State Law

Federal law lacks a corporation minimum tax.

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 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 \times 8.84\% = \799).

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 6th month of the taxable year. A penalty of 10 percent of the amount of underpayment will be added to any fee paid late.

This Bill

For taxable years beginning on or after January 1, 2020, this bill would reduce the annual tax for an LLC that is a small business, as defined, within its first two years of operation from \$800 to \$400. The bill would define the following terms and phrases:

- "Gross receipts, less return and allowances reportable to this state," means the sum of the gross receipts from the production of business income,¹ and the gross receipts from the production of nonbusiness income.²
- "Small business" means an LLC that reasonably estimates it will have, gross receipts, less returns and allowances, reportable to this state for the taxable year of \$250,000 or has fewer than five employees

The LLCs return for a taxable year must be filed by the due date of the return without regard to extension for the reduced annual tax to apply.

Implementation Considerations

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

This bill uses a phrase that is undefined, "first two years of operation." The absence of definitions to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended the bill be amended.

The reasonable estimate of gross receipts is specified as \$250,000. If the author intends for the reasonable estimate to include amounts less than \$250,000, this bill must be amended.

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

² As defined in R&TC section 25120(d).

The bill allows small business LLCs with fewer than five employees to pay an annual tax of \$400 regardless of the amount of their gross receipts. If this is contrary to author's intent, the bill should be amended.

It is unclear when the start date for the "first two years of operation" would be. For clarity and ease of administration the author may wish to amend the bill to include a reference to the dates in paragraph (1) of subdivision (b).

Technical Considerations

In subdivision (g), the wording "Notwithstanding any provision of this section to the contrary" is unclear. For clarity, it is suggested that the bill be amended to read "Notwithstanding subdivision (a)".

Legislative History

AB 2510 (Muratsuchi, 2017/2018) would, for taxable years beginning on or after January 1, 2018, require an LLC that is a microbusiness to pay an annual tax of \$100. AB 2510 is currently in the Assembly Revenue and Taxation Committee.

AB 1432 (Melendez, 2017/2018) would have eliminated the minimum franchise tax for every new corporation for the first five taxable years. AB 1432 failed to pass out of the Assembly by the constitutional deadline.

AB 1256 (Brough, 2017/2018) would have reduced the minimum franchise or annual tax for new entities in California. AB 1256 failed to pass out of the Assembly by the constitutional deadline.

SB 248 (Morrell, 2017/2018) would have eliminated the annual tax for the first taxable year and reduced the minimum franchise or annual tax to \$400 for new, small business corporations, LLCs, limited liability partnership (LLP), and limited partnerships (LPs). SB 248 failed to pass out of the Senate by the constitutional deadline.

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

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 to pass 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 to pass out of the Assembly by the constitutional deadline.

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 to pass 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 to pass 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 including LLCs electing to have their business treated like a corporation for tax purposes.

Illinois imposes a \$25 minimum and a \$2 million maximum tax on corporations including LLCs electing to have their business treated like a corporation for tax purposes.

Massachusetts imposes a minimum tax of \$456 on corporations, including LLCs electing to have their business treated like a corporation for tax purposes.

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

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.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2410 as Introduced February 14, 2018
For Taxable Years Beginning On or After January 1, 2020
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	- \$17
2020-2021	- \$47
2021-2022	- \$65

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

Revenue Discussion

Based on Franchise Tax Board income data for LLCs for the 2015 taxable year, it is estimated that in the 2020 taxable year there would be approximately 75,000 LLCs with less than five employees or gross receipts equal to \$250,000 that would be subject to the annual tax under current law and would benefit from the reduction of the annual tax to \$400. This would result in an estimated revenue loss of \$30 million in the 2020 taxable year. For the 2021 taxable year, it is estimated that 150,000 first- and second-year LLCs would benefit from the annual tax reduction for a total estimated revenue loss of \$60 million.

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 reducing the annual tax to \$400 for small business LLCs for the first two years of operation would increase business in California.

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

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