

For the tax year in which the business ceases to exist, the business entity must check the box indicating that the federal tax return is a “final return.”

Current State Law

In general, if the Franchise Tax Board (FTB) is unable to collect a debt from a taxpayer, current state law¹ allows the FTB to extinguish the uncollected debt after 20 years. However, the entity will continue to exist and accrue taxes, interest, and penalties, until it is properly dissolved.²

This Bill

This bill would provide a qualified entity with two options for administrative dissolution when there is unpaid minimum franchise or annual tax.

Option 1: FTB-Initiated Administrative Dissolution (Involuntary)

This option would allow the FTB to administratively dissolve those domestic corporations and domestic LLCs that are suspended by the FTB, have ceased doing business, have been suspended for 60 or more consecutive months, and have paid all taxes and filed all returns due as of the date the entity ceased doing business.

Prior to the administrative dissolution under this option of the bill, the FTB would be required to provide written notice to the business entity of the pending administrative dissolution. The FTB would transmit to the Secretary of State (SOS) the names and SOS file numbers of domestic corporations and domestic LLCs subject to the administrative dissolution. Upon receipt of the transmission, the SOS would also be required to provide on its website a 60 calendar-day notice of a pending administrative dissolution by listing the corporation or LLC name, and the SOS's file number, as applicable.

The notified corporation or LLC would be allowed to file a written objection with the FTB to object to the administrative dissolution. If a timely written objection is received by the FTB, the domestic corporation or domestic LLC would have an additional 90 days to pay or otherwise satisfy all accrued taxes, penalties, and interest, file a current Statement of Information with the SOS, fulfill any other requirements to be eligible, and apply for revivor. The 90-day period may be extended for no more than one period of up to 90 days, by the FTB. If there is no written objection or the written objector fails to revive, the domestic corporation or domestic LLC would be administratively dissolved. Upon administrative dissolution, the FTB would abate the domestic corporation's or domestic LLC's liabilities for qualified taxes, interest, and penalties.

The administrative dissolution of a corporation shall not diminish or adversely affect the ability of the Attorney General to enforce liability as otherwise provided by law.

¹ Revenue & Taxation Code (R&TC) section 19255.

² Corporations Code sections 200(c) & 17701.04(c).

No administrative appeal, writ, or other judicial action may be taken based on the FTB's or the SOS's action, except if related to repayment of amounts erroneously received after administrative dissolution has occurred.

Upon administrative dissolution, the corporate rights, powers, and privileges of the corporation shall cease.

Option 2: Taxpayer-Initiated Administrative Dissolution (Voluntary)

This option would be available to domestic corporations and domestic LLCs that have never done business or have ceased doing business within California, have paid all taxes due for years when the business was in operation, and filed all required returns prior to the cessation of business operations.

Under this option, taxpayers applying for administrative dissolution would be required to do all of the following:

- Request in writing from the FTB abatement of any unpaid qualified taxes, interest, and penalties.
- File dissolution paperwork with the SOS prior to requesting administrative dissolution with the FTB.
- Establish that it has ceased all business activity and has no remaining assets at the time of filing the request for abatement.

The FTB may prescribe any regulations that may be necessary or appropriate to implement the purposes of this section.

Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code shall not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established by the FTB.

The bill would define the following:

- "Qualified entity" means a domestic corporation³ or a domestic LLC⁴ that satisfies either of the following conditions:
 - Was never doing business⁵ in California at any time after the time of its incorporation in California.
 - Was previously doing business,⁶ and has filed all returns required under Section 18601, 18633, or 18633.5 for the tax years prior to cessation of doing business.

³ Subject to corporation subject to Division 1 (commencing with Section 100) of Title 1 of the Corporations Code.

⁴ Subject to Title 2.6 (commencing with Section 17701.01) of the Corporations Code.

⁵ Within the meaning of subdivision (a) of Section 23101.

⁶ Within the meaning of subdivision (a) of Section 23101.

- “Qualified taxes, interest, and penalties” would mean tax imposed under R&TC sections 17941 or 23153 and associated interest, and penalties, and any penalties imposed under R&TC section 19141. “Qualified taxes, interest, and penalties” would specifically exclude taxes and fees imposed under R&TC sections that govern the LLC fee, measured corporate tax, unrelated business income of a trust or exempt organization,⁷ or associated interest or penalties, and does not include additional tax, penalties or interest resulting from a final or pending state or federal audit. “Qualified taxes” subject to abatement would be limited to the minimum or annual tax.

If a qualified entity has been dissolved but continues to do business,⁸ or has any remaining assets which were not disclosed by the qualified entity at the time of the request for abatement,⁹ the total tax, interest, and penalties that were abated shall be immediately due and payable. In addition, a penalty equal to 50 percent of the total tax abated, plus interest payable pursuant to Section 19101 on that amount for the period or periods beginning on the last date prescribed by law for the payment of that tax, determined without regard to extensions, and ending on the date the tax was abated, shall be imposed. This penalty would be in addition to any other penalty imposed.¹⁰

Implementation Considerations

Implementing this bill would require changes to existing tax forms and instructions, and information systems, and additional staff to process the administrative dissolution program workload.

Technical Considerations

To correct a grammatical error, on page 3, line 27, strike “day’s” and insert “days”

Legislative History

AB 557 (Irwin, Chapter 363, Statutes of 2015), established an administrative dissolution process for nonprofit entities.

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.

⁷ R&TC sections 17942, 23501 or 23731.

⁸ Within the meaning of subdivision (a) of Section 23310.

⁹ Under Section 23310.

¹⁰ Under Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401) and Part 11 (commencing with Section 23001).

Florida, Michigan, and Minnesota lacks a minimum tax on business entities and would not have the same issues this bill would address.

Illinois, Massachusetts, and New York impose a minimum tax on corporations and in some cases on LLCs, depending on how the LLC is treated for federal tax purposes. These states also have dissolution procedures similar to California's in that the entity must file a final tax return and pay any tax liability and file with the appropriate agency (SOS for Illinois, Department of Revenue for Massachusetts, and New York Department of State for New York).

Fiscal Impact

The department estimates an annual workload of 9,000 requests for voluntary administrative dissolutions. Based on the projected volume, staff estimates a cost of approximately \$323,000 in fiscal year 2017/2018 and ongoing annual costs of \$399,000 to develop and administer the administrative dissolution program, inclusive of system programming and testing costs.

Cost savings attributable to the bill's administrative dissolution process are estimated to be in the range of \$115,000 to \$280,000 per year.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2503 as Introduced on February 14, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

(\$ in Millions)

| Fiscal Year | Revenue |
|-------------|--------------------|
| 2018-2019 | - \$2.9 to - \$6.7 |
| 2019-2020 | - \$3.7 to - \$9.2 |
| 2020-2021 | - \$1.7 to - \$5.5 |

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

This estimate is based upon historical payment data for entities that may elect to dissolve or may meet the requirements for administrative dissolution. The revenue impact could vary widely depending on the amounts that would have been collected from entities that would be, or would elect to be, dissolved.

FTB-Initiated Dissolution (Involuntary)

Based upon historical payment data, the estimated revenue loss from administratively dissolving entities that have been suspended for at least 60 months would be between \$450,000 and \$2.4 million. This is equal to the amount of revenue that would have been received in the 2019 taxable year.

Taxpayer-Initiated Dissolution (Voluntary)

Based upon historical payment data, the estimated revenue loss from entities that may elect to voluntarily dissolve would be between \$5.4 million and \$11 million. This is equal to the amount of revenue that would have been received in the 2019 taxable year.

The tax-year estimates for involuntary and voluntary dissolution are combined and converted to fiscal-year estimates and then rounded to arrive at the amounts reflected in the above table.

Potential Additional Revenue Impact

Because the FTB sometimes receives income information more than five years after an entity was suspended, the FTB may incur an additional revenue loss on administratively dissolved business entities. Although the FTB could technically assess and pursue collections in these instances, the collection potential could be significantly impaired.

Based upon payment data received by the FTB after the 60th month of suspension, taxpayers suspended in excess of 60 months paid an estimated \$1 million per year on average. This indicates there may be an additional revenue loss subsequent to administrative dissolution to the extent the FTB is unable to collect any additional tax assessed. Because it is difficult to predict the frequency and value of future assessments based upon new income information, the revenue impact could vary widely.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some may argue that allowing administrative dissolutions for domestic corporations and domestic LLCs that are no longer doing business and have no assets, would allow those businesses that are unable to pay their tax liabilities a way to properly dissolve their business, thus allowing the department to focus on collectable debt.

Opponents: Some may argue that a process to abate amounts due from noncompliant taxpayers, even though they have ceased doing business and have no assets, would inadvertently encourage broader noncompliance.

Policy Concerns

The proposed administrative dissolution process would abate the liabilities of noncompliant taxpayers that are unable to pay their legally owed tax obligations. Some of these taxpayers may have paid all or some of their liabilities absent this program.

Because the bill fails to include other entities subject to the Personal Income Tax Laws, similarly situated business entities could receive different treatment.

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