



## Analysis of Original Bill

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Sponsor:

Bill Number: AB 2510

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Introduced: February 14, 2018

Attorney: Bruce Langston

Related Bills: See Legislative  
History

**Subject:** Annual Tax/Reduce to \$100 for LLC Microbusiness/Extend Exemption for LLC Small Business Owned by Deployed Member of the U.S. Armed Forces

### Summary

This bill would, under the Personal Income Tax Law (PITL), modify the annual tax paid by certain limited liability companies (LLCs).

**Recommendation – No position.**

### Reason for the Bill

The reason for the bill is to help microbusiness LLCs and those LLCs owned by a deployed member of the United States Armed Forces by offering a reduction or elimination of 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, 2018.

### Federal/State Law

Federal law lacks an annual minimum tax for LLCs and 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.

The exemption from the \$800 annual tax for LLCs that are small businesses, as defined, that are solely owned by a deployed member of the Armed Forces that either ceases operations during or operates at a loss for a taxable year expired for taxable years beginning on or after January 1, 2018.

### **This Bill**

This bill would, for taxable years beginning on or after January 1, 2018, allow an LLC that is a microbusiness to pay a reduced annual tax of \$100.

“Microbusiness” would mean an LLC with a total income from all sources derived from, or attributable to, the State of \$150,000 or less.

Additionally, this bill would reinstate and extend in perpetuity the exemption from the annual tax for small business LLCs that are solely owned by a deployed member of the Armed Forces that either cease operations or operate at a loss indefinitely.

### **Implementation Considerations**

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

It is unclear as to how the exemption from the annual tax would be applied for otherwise eligible LLCs that merge or convert their entity type. For clarity and to ensure consistency with the author’s intent, the bill should be amended.

If this bill is enacted in late September or October of 2018, the department would have developed the forms and instructions for the 2018 taxable year. Thus, the department may incur additional costs to develop alternative forms and instructions in the short time frame necessary to ensure they are available for taxpayers to comply with the filing requirement. To alleviate these concerns, the author may wish to change the operative date to January 1, 2019.

## Technical Considerations

To eliminate a circular reference and clarify that the exemption from the annual tax is controlling, paragraph (1) of subdivision (g) needs to be amended where the phrase "Notwithstanding any provision of this section to the contrary" appears, as it should be "Except as otherwise provided in subdivision (f)".

## Legislative History

AB 2410 (Grayson, 2017/2018) would reduce the annual tax for LLCs that are a small business, as defined, within its first two years of operation from \$800 to \$400. AB 2410 is currently in the Assembly Revenue and Taxation Committee.

AB 1085 (Calderon, 2017/2018) would replace the specified due date for the LLC annual tax and corporation estimate tax of the minimum franchise tax only, with the three payment options. AB 1085 is currently in the Senate.

AB 1256 (Brough, 2017/2018) would have reduced the minimum franchise tax or annual tax for every new small business to \$100. AB 1256 failed to pass out of the house of origin by the constitutional deadline.

SB 248 (Morrell, 2017/2018) would have eliminated the annual tax for the first taxable year and reduce the minimum franchise or annual tax to \$400 for new, small business corporations, LLCs, LLP, and limited partnerships (LPs). SB 248 failed to pass out of the house of origin 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 house of origin 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 house of origin 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 2510 as Introduced February 14, 2018  
For Taxable Years Beginning On or After January 1, 2018  
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$500
2019-2020	- \$360
2020-2021	- \$390

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 (FTB) income data for LLC for the 2015 taxable year, it is estimated that in the 2018 taxable year approximately 430,000 LLCs would be subject to the annual tax under current law and would benefit from the reduction of the annual tax to \$100. The estimated revenue loss from the reduction of the annual tax to \$100 for LLCs would be approximately \$300 million.

Current law allows a minimum franchise tax exemption to small businesses solely owned by deployed members of the Armed Forces, whose business operates at a loss or cease to exist. Because the FTB is unable to predict future deployment and business operations, the revenue impact of extending the sunset date is unknown. It is expected that for every 100 small businesses that would have paid the minimum franchise tax there would be a revenue loss of \$65,000.

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 the bill would give a needed tax break to LLCs in California and therefore assist them to stay in business.

Opponents: Some may argue that providing a tax break to LLCs only may be overly narrow and inadvertently exclude other business owners that need assistance.

## **Policy Concerns**

This bill would provide a tax benefit for specified LLCs subject to the PITL that would not be provided to other business types, including specified LLCs subject to the Corporation Tax Law. Thus, this bill would provide differing treatment based solely on classification.

## **Legislative Staff Contact**

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