



## **Analysis of Original Bill**

Author: Cannella	Sponsor:	Bill Number: SB 1417
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Attorney: Bruce Langston	Related Bills: See Legislative History	

**Subject:** Minimum Franchise Tax Based on Gross Revenue of Corporation

### **Summary**

This bill would, under the Corporation Tax Law (CTL), modify the minimum franchise tax for corporations having less than \$15 million in gross revenue.

**Recommendation - No position.**

### **Reason for the Bill**

The reason for this bill is to provide much needed relief for small businesses in California.

### **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**

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 ( $\$9,039 \times 8.84\% = \$799$ ).

Every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, is exempt from the minimum franchise tax for its first taxable year. This exemption does not apply to any corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax. It also does not apply to limited partnerships (LPs); limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), charitable organizations, regulated investment companies (RICs), real estate investment trusts (REITs), real estate mortgage investment conduits (REMICs), financial asset securitization investment trusts, and qualified Subchapter S subsidiaries.

Under existing state law, the annual tax on LPs, LLCs not classified as corporations, S corporations, LLPs, REITs, and REMICs, is set at \$800 by reference to the minimum franchise tax.

### **This Bill**

For taxable years beginning on or after January 1, 2019, this bill would, modify the minimum franchise tax imposed on a corporation based on the gross revenue of a corporation, and would also have the effect of reducing the annual tax of some other types of business entities which reference the minimum franchise tax to compute their annual tax.

The minimum franchise tax modification based on the level of gross revenue of the corporation would be as follows:

<u>Gross revenue less than \$2,500,000</u>	<u>Gross revenue of \$2,500,000 or more but less than \$7,500,000</u>	<u>Gross revenue of \$7,500,000 or more but less than \$15,000,000</u>	<u>Gross revenue of \$15,000,000 or more</u>
\$200	\$400	\$600	\$800

### **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.

This bill uses terms that are undefined, i.e., "gross revenue." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill to clearly define the terms.

Since other types of business entities reference the minimum franchise tax to compute their annual tax, reducing the minimum franchise tax provision would also have the effect of reducing the annual tax for such entities. If different than the author's intent, the author may wish to amend the bill to specifically reduce only the corporate minimum franchise tax, leaving the provision intact to preserve the existing cross-references.

### **Legislative History**

AB 2131 (Melendez, 2017/2018) would reduce the minimum franchise tax from \$800 to \$400. AB 2131 is pending before the Assembly Appropriations Committee.

AB 2410 (Grayson, 2017/18) would reduce the annual tax for LLCs that are a small business, as defined, within the first two years of operation from \$800 to \$400. AB 2410 is pending before the Assembly Revenue and Taxation Committee.

AB 1085 (Calderon, 2017/2018) would allow corporations and LLCs the option to pay their minimum franchise or annual tax in 2 or 3 installments. AB 1085 is pending before the Senate Governance and Finance Committee.

AB 2625 (Lopez, 2015/2016) would have reduced the minimum franchise and annual tax on certain new microbusiness entities. AB 2625 failed to pass out of the Assembly by the constitutional deadline.

AB 328 (Grove, 2015/2016) would have exempted new veteran owned small corporations and LLCs from the minimum franchise or annual tax. AB 328 failed to pass out of the Assembly by the constitutional deadline.

AB 2428 (Patterson, 2013/2014) would have eliminated the minimum franchise tax for new business entities for up to five taxable years. AB 2428 failed passage 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 passage out of the Assembly by the constitutional deadline.

AB 2495 (Melendez, 2013/2014) would have eliminated the minimum franchise tax for new business entities for up to five taxable years. AB 2495 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 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, Massachusetts, and New York* do impose a minimum tax on corporations, but they lack a graduated tax based on gross revenue similar to the one proposed in this bill.

### **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 SB 1417 as Introduced February 16, 2018  
For Taxable Years Beginning On or After January 1, 2019  
Assumed Enactment after June 30, 2018

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	- \$450
2019-2020	- \$850
2020-2021	- \$950

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

The provisions of this bill specify that the amount of minimum franchise tax be determined in accordance with the taxpayer's "gross revenue." Because the term "gross revenue" is not defined, the above estimate was calculated by substituting total income for gross revenue. Should the definition of gross revenue be defined in a subsequent bill, the amounts in the table above are subject to change.

Based on data from the Franchise Tax Board for tax years 2012-2015, it is estimated that in taxable year 2019 approximately 650,000 corporations and 600,000 LLCs, LLPs, and LPs would be impacted by the changes to the amount of the minimum franchise tax as proposed in this bill.

The estimated revenue loss from the proposed changes to the minimum franchise tax for C and S corporations would be approximately \$350 million in the 2019 taxable year. This consists of minimum franchise tax 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 than the minimum franchise tax. The estimated revenue loss from the proposed changes to the minimum franchise tax for LLCs, LLPs, and LPs, would be approximately \$475 million.

This results in an overall loss of approximately \$850 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<sup>1</sup>**

Support: California Small Business Association.

Opposition: None provided.

## **Arguments**

Proponents: Some may argue that the tax relief provided by this bill would reduce the financial pressure on certain small businesses.

Opponents: Some may argue that this bill doesn't go far enough to provide relief for other types of businesses that may be struggling.

## **Legislative Staff Contact**

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<sup>1</sup> Bill Sponsor per author's fact sheet.