STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Amended Bill

Author: Gaines, et al.	Sponsor:	Bill Number: SB 996
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Subject: Corporation Taxes: Tax Rates

Summary

This bill would, under the Corporation Tax Law (CTL), reduce the corporate tax rate from 8.84 percent to 6.84 percent.

Recommendation – No Position

Summary of Amendments

The March 21, 2018, amendments removed provisions of the bill related to the Revenue and Taxation Code relating to property tax and replaced them with the provisions discussed in this analysis.

The April 5, 2018, amendments added coauthors and made a nonsubstantive technical change.

This is the department's first analysis of the bill.

Reason for the Bill

The reason for this bill is to incentivize corporate entities to remain in or relocate to California by reducing the corporate tax burden.

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

Under federal law, all corporations are required to file an annual tax return whether or not they have taxable income. Corporations with taxable income are taxed at a flat tax rate of 21 percent.

Existing state law levies three primary taxes under the CTL.

1. Corporate Franchise Tax: Every corporation either qualified to do business in this state or doing business in this state (whether organized in-state or out-of-state) is subject to the corporate franchise tax. The franchise tax is not a tax on income. Rather, it is a tax measured by net income for the privilege of doing business within the state. The corporate franchise tax rate is 8.84 percent. The S corporation franchise tax rate is 1.5 percent.

   Under existing law, taxpayers are subject to a minimum franchise tax of $800 only if it is more than their measured tax. Currently, only taxpayers whose net income is less than approximately $9,045 pay the minimum franchise tax because their measured tax would be less than $800 ($9,045 x 8.84% = $799). S corporations pay only the minimum franchise tax until their net income exceeds $53,300.

2. Corporate Income Tax: In general, corporations that are not organized in or qualified to do business in California and not "doing business" in California, but are deriving income from California sources, are subject to the corporate income tax. This tax is set at 8.84 percent by reference to the corporate franchise tax rate. The corporate income tax also applies to certain non-corporate business entities. However, the minimum franchise tax does not apply to entities subject to the corporate income tax.

3. Bank Tax: Banks and financial institutions doing business in this state are subject to the bank tax rate. The bank tax rate equals the sum of the corporate franchise tax rate plus 2 percent.

This Bill

This bill would reduce the corporate tax rate from 8.84 percent to 6.84 percent for taxable years beginning on or after January 1, 2018.

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.

Because the rate reduction would apply to taxable years beginning on or after January 1, 2018, taxpayers filing a short period return ending prior to the bill's enactment date would be required to file an amended return to apply the lower rate and receive a refund. Additionally, 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 reporting requirement. The author may wish to amend the bill to apply to taxable years beginning on or after January 1, 2019, to avoid these complications and costs.

Legislative History

SB 1398 (Skinner, 2017/2018) among other things, would modify the corporate tax rate for publicly-held corporations for taxable years beginning on January 1, 2019, to a tax rate based on a compensation ratio calculated for the taxable year. SB 1398 is currently in the house of origin.

SB 684 (Hancock and Leno, 2015/2016) would have modified the corporation tax rate for publicly held corporations to a rate determined by a reference table tied to a "compensation ratio." SB 684 failed to pass out of the Senate by the constitutional deadline.

SB 1372 (DeSaulnier, 2013/2014) would have modified the corporate tax rate for publicly held companies and created a tax credit for corporations that meet certain criteria. SB 1372 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 similarities to California's economy, business entity types, and tax laws.

All six states levy a corporate income tax with rates ranging from 5.5 percent in *Florida* to 9.8 percent in *Minnesota*. The corporate tax rates in the remaining states are: 6.0 percent in *Michigan*, 6.5 percent in *New York*, 8.0 percent in *Massachusetts*, and 9.5 percent in *Illinois*.

Florida, Illinois, Massachusetts, Michigan, and Minnesota, laws do not provide, or propose, a corporate tax rate reduction comparable to the one proposed in this bill.

As part of *New York's* corporate tax reform plan, beginning on or after January 1, 2015, the tax rate for qualifying non-manufacturing corporations with less than $1 million of New York City (NYC) business income was reduced from 8.85 percent to 6.5 percent. Smaller reductions were applied to corporations with NYC business income between $1 million and $1.5 million, and overall business income between $2 million and $3 million. Corporation tax rates for manufacturing corporations declined from 8.85 percent to 4.425 percent, with lesser reductions for manufacturing corporations with NYC business income between $10 million and $20 million, and overall business income between $20 million and $40 million. The corporation tax rates for financial corporations with more than $100 billion is assets is 9 percent.

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 996 as Amended April 5, 2018
For Taxable Years Beginning On or After January 1, 2018
Assumed Enactment after June 30, 2018

($ in Billions)

Fiscal Year	Revenue
2018-2019	- $2.5
2019-2020	- $2.3
2020-2021	- $2.2

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 the Franchise Tax Board's Corporate Income Tax micro-simulation model, it is estimated that in taxable year 2018, reducing the C corporation tax rate to 6.84 percent and by doing so, reducing the Bank and Financial Corporation tax rate to 8.84 percent would result in a $1.9 billion revenue loss. The tax-year estimates are converted to fiscal-year estimates, and then rounded to arrive at the amounts in the above table.

Support/Opposition

Support: None provided.

Opposition: None provided.

Arguments

Proponents: Some may argue that reducing the corporate tax rate would encourage businesses to remain in California.

Opponents: Some may argue, the cost to the General Fund due to the corporate tax rate reduction would outweigh the benefit of corporate retention or relocation in the state.

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