STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Melendez	Sponsor:	Bill Number: AB 2306
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Attorney: Shane Hofeling	Related Bills: See Legislative History	

SUBJECT

Repeal of Corporate Minimum Franchise Tax

SUMMARY

This bill would, under the Corporation Tax Law (CTL), repeal the $800 corporate minimum franchise tax for corporations doing business in the state for taxable years beginning on or after January 1, 2020.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to remove the minimum tax imposed on corporations doing business in the state.

ANALYSIS

This bill would, for taxable years beginning on or after January 1, 2020, repeal the corporate minimum franchise tax for corporations doing business in the state.

Corporations doing business within the limits of this state, and not expressly exempted from taxation by the provisions of the California Constitution, pay tax for the privilege of exercising their corporate franchises within this state. The franchise tax is determined by multiplying the corporation's net taxable income by the current tax rate of 8.84 percent. Currently, corporations pay the greater of the measured tax amount, or the minimum franchise tax of $800.

For taxable years beginning on or after January 1, 2020, corporations doing business in the state would continue to pay the measured franchise tax as described above, but would no longer be subject to the $800 minimum franchise 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

Unless specifically exempted by statute, every corporation that is incorporated in California, qualified to transact business in California, or doing business in California (whether organized in state or out-of-state), is subject to the minimum franchise tax of $800. Taxpayers must pay the minimum franchise tax unless their measured franchise tax is greater. For taxable years beginning on or after January 1, 1997, the measured tax is imposed on net income at a rate of 8.84 percent. Thus under current law, only corporations with net income less than approximately $9,040 pay the minimum franchise tax because their measured tax would be less than $800 ($9,039 x 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 is inapplicable to a corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax. The first taxable year exemption 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), and financial asset securitization investment trusts (FASITs).

In general, under the CTL, corporations, Subchapter S corporations, RICs, REITs, REMICs, and FASITs are subject to the $800 minimum franchise tax.

In general, under the Personal Income Tax Law (PITL), LPs, LLCs not classified as corporations, and LLPs, are subject to an annual tax.

For taxable years beginning on or after January 1, 2020, an LLC or corporation that is a small business solely owned by a deployed member of the United States (U.S.) Armed Forces is not subject to the annual or minimum franchise tax for any taxable year that the owner is deployed and the LLC or corporation operates at a loss or ceases operation.

Federal law does not require payment of an annual or minimum tax.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

In Revenue and Taxation Code (R&TC) sections 23153(b)(1) and 23153(d)(2), the bill provides, "For taxable years beginning before January 1, 2020." The author may want to amend the bill to include the date in which this provision would first be operative to ensure that this section is applied to the appropriate taxable years.

Technical Considerations

Department staff has identified technical issues with the bill language that could cause confusion about how the bill is to be applied to corporations not doing business in California, but are subject to the minimum franchise tax. If this bill goes forward, department staff is available to work with the author's office to resolve these and other concerns that may be identified.

Policy Concerns

Under R&TC section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit. The author may want to amend the bill to include these requirements.

This bill lacks a sunset date, which is generally provided to allow periodic review of the effectiveness of income tax law changes by the Legislature.

LEGISLATIVE HISTORY

AB 2929 (Arambula and Muratsuchi, 2019/2020) would, under the PITL and the CTL, reduce the annual tax for certain single-member LLCs and the minimum franchise tax for certain single-owner corporations to provide that these taxpayers would not be subject to the tax in their first taxable year, and for the following four years, the tax would incrementally increase annually by two hundred dollars ($200); with a limitation of minimum tax reduction of one hundred million dollars ($100,000,000) per taxable year and annual tax reduction of one hundred million dollars ($100,000,000) per taxable year, administered by the FTB on a first-come-first-served basis. AB 2929 is currently referred to the Assembly Revenue and Taxation Committee.

AB 308 (Muratsuchi, et al., Chapter 421, Statutes of 2019), under the PITL and the CTL, allowed an exemption from the annual tax or the minimum franchise tax for certain small business LLCs, and corporations that are solely owned by a deployed member of the U.S. Armed Forces for taxable years beginning on or after January 1, 2020, and before January 1, 2030.

SB 349 (Portantino, 2019/2020) would have reduced the minimum franchise tax for corporations having less than $15 million in gross receipts. SB 349 was vetoed by the governor whose veto message stated in part, "The intent of this measure is to provide tax relief for smaller California businesses and to encourage economic growth. Both are important goals which I support, and helping small businesses is certainly a priority I share with the Legislature. However, this proposal would be better addressed through the annual budget process."

AB 250 (Choi, 2019-2020), substantially similar to SB 349 (Portantino, 2019/2020), would have also reduced the minimum franchise tax for corporations having less than $15 million in gross receipts. AB 250 failed to pass out of the Assembly by the constitutional deadline.

AB 2131 (Melendez, 2017/2018) would have reduced the minimum franchise tax from $800 to $400. AB 2131 failed to pass out of the Assembly by the constitutional deadline.

AB 2410 (Grayson, 2017/2018) would have reduced 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 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, as applicable. AB 328 failed to pass out of the Assembly by the constitutional deadline.

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.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill would impact the department's systems, resulting in programming and processing revisions. The department's costs to implement this bill have yet to be determined, but would be significant. As the bill continues to move 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 2306 as Introduced February 14, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	-$1,000
2021-2022	-$900
2022-2023	-$850

Using data from taxable year 2017 returns filed with FTB, it is estimated that in taxable year 2020 approximately 700,000 C and S corporations would be impacted by the repeal of the minimum franchise tax as proposed in this bill.

The estimated revenue loss consists of the minimum franchise tax that would no longer be paid offset by calculated measured franchise tax. This is determined by multiplying the S or C corporation’s net taxable income by their current tax rate. The revenue loss would be approximately $1 billion in the 2020 taxable year.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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