STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Arambula & Muratsuchi

Analyst: Elaine Warneke

Attorney: Shane Hofeling

Sponsor:

Phone: (916) 845-7746

Related Bills: See Legislative History

Bill Number: AB 2929

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SUBJECT

Reduction of Single-member Limited Liability Company Annual Tax and Single-owner Corporation Minimum Franchise Tax

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), reduce the annual tax for certain single-member limited liability companies (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 Franchise Tax Board (FTB) on a first-come-first-served basis.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to assist LLC single members or corporate single owners with low or moderate income.

ANALYSIS

This bill would, for taxable years beginning on or after January 1, 2021, reduce the annual and minimum franchise taxes imposed on certain LLCs and corporations.

A single-member LLC would not be subject to an annual tax for its first taxable year. It would then be subject to an annual increase in tax by two hundred dollars ($200), commencing in the second taxable year, and every taxable year thereafter, until the LLC is subject to 100 percent of the tax imposed, or, currently, eight hundred dollars ($800). In addition, a single-owner corporation would not be subject to the minimum franchise tax for its first taxable year. It would then be subject to an annual increase in tax by two hundred dollars ($200), commencing in the second taxable year, and every taxable year thereafter, until the corporation is subject to 100 percent of the tax imposed, or, currently, eight hundred dollars ($800). (As explained below, for the first taxable year, under present law, corporations are exempt from paying the minimum franchise tax.)

The FTB would allow the reduction of the annual and minimum franchise taxes on a first-come-first-served basis, determined by the date the taxpayer's timely filed, original tax return is received. Each total reduction in the annual and minimum franchise taxes cannot exceed one hundred million dollars ($100,000,000) per each taxable year, for a total limitation of two hundred million dollars ($200,000,000).

The date a return is received would be determined by the FTB, and that determination may not be reviewed in any administrative or judicial proceeding. In addition, should reductions claimed exceed the annual one hundred million dollar ($100,000,000) limitation, the allowed reductions would be determined on a first-come-first-served basis. Any disallowance of a reduction claimed would be treated as a mathematical error appearing on the return. Any disallowed amount would be assessed by the FTB in the same manner as provided by Revenue and Taxation Code (R&TC) section 19051, which is in the form of a Notice of Tax Due, which is due and payable on demand.

The following definitions apply for purposes of the reduction in tax called for by this bill:

- "Member of low or moderate income" means a person of low or moderate income, as defined by Section 50093 of the Health and Safety Code (HSC).
- "Single-member limited liability company" means an LLC in which the company has only one member of low or moderate income and that member has not previously benefitted from a tax reduction, other than application of this bill.
- "Owner of low or moderate income" means a person of low or moderate income, as defined by Section 50093 of the HSC.
- "Single-owner corporation" means a corporation in which the corporation has only one owner of low or moderate income and that owner has not previously benefitted from a tax reduction, other than application of this bill.

In general, HSC Section 50093 defines a "person of low or moderate income" to mean a person whose income does not exceed 120 percent of area median income with certain allowed adjustments.

As required under R&TC section 41, this bill would provide for the specific goals, purpose, and objectives of providing this benefit to assist low and moderate income entrepreneurs in starting small businesses, and the needed measures to evaluate the effectiveness of the benefits.

The Legislative Analyst's Office (LAO) must prepare and submit a report to the Legislature, on or before December 1, 2023, and every five years thereafter, on the effectiveness of the benefits of this legislation. The report must include information on the number of taxpayers claiming the benefits and total amount of the benefits provided per taxable year. The LAO may request information as needed from the FTB for this reporting purpose. Notwithstanding R&TC section 19542, the FTB must provide any data requested by the LAO, as allowed pursuant to the R&TC.

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, 2021.

Federal/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 of $800. Taxpayers must pay the minimum franchise tax unless their measured 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).

In general, under the CTL, corporations, Subchapter S corporations, regulated investment companies (RICs), real estate investment trusts (REITs), real estate mortgage investment conduits (REMICs), and financial asset securitization investment trusts (FASITs) are subject to the $800 minimum franchise tax.

In general, under the PITL, limited partnerships (LPs), LLCs not classified as corporations, and limited liability partnerships (LLPs) are subject to an annual tax.

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. In addition, the exemption does not apply to LPs; LLCs not classified as corporations, LLPs, charitable organizations, RICs, REITs, REMICs, and FASITs.

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

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 would provide that the one-hundred-million-dollar ($100,000,000) annual limitation applies to the total reduction of both the annual and minimum franchise taxes, not to each tax classification separately, which would provide a two-hundred-million-dollar ($200,000,000) total limitation. For clarity and ease of administration, it is recommended that the bill be amended to clarify the author's intent and provide coordination between the annual and minimum franchise taxes.

This bill would provide that the limitation would be applied to both the annual and minimum franchise taxes simultaneously, on a first-come-first-served basis. In addition, certain entities qualify for the first taxable year exemption allowed under current law. Should these exemptions be applied to the annual limitation? For clarity and ease of administration, it is recommended that the bill be amended to clarify the author's intent and provide coordination between the annual and minimum franchise taxes, and whether the exemption allowed under current law should be included in the limitation.

The bill refers to timely filed original returns. If that is a requirement to qualify for the reduction, for clarity and ease of administration, it is recommended that the bill be amended to clarify the author's intent.

The bill is silent on whether an LLC or corporation can amend the tax return to file a claim for refund if they did not apply the provisions of this bill, and the one hundred million dollar ($100,000,000) limitation has not been reached. The bill is also silent on whether the reduction would apply automatically, or if the reduction would have to be requested or claimed, like a credit. For clarity and ease of administration, it is recommended that the bill be amended to clarify the author's intent.

The FTB lacks the expertise to determine if the LLC's single member or the corporation's single owner has low or moderate income, as defined by the HSC, to qualify for this tax reduction. Typically, these determinations involving areas for which the department lacks expertise are certified by another agency or agencies that possess the relevant expertise. The certification language should specify the responsibilities of both the certifying agency and the taxpayer. It is recommended that this bill be amended to include a certifying agency.

To qualify for this reduction, the member or owner could not have previously, "benefitted from a tax reduction." The use of the term "tax reduction" is undefined. This could be interpreted to mean anything that would reduce tax, such as other credits or deductions allowed under the R&TC, and does not specify which taxable year would be considered, the current taxable year or a prior year. Is there a look-back period? The absence of a definition to clarify this term 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 term.

This bill would require significant systems modifications to identify taxpayers that qualify for the reduction, a modified calculation for the annual and minimum franchise taxes for qualifying taxpayers, the tracking of cumulative reduced annual and minimum franchise taxes to ensure the annual total limit of one hundred million dollars ($100,000,000) is not exceeded, a new form, "check" box or worksheet with instructions to be developed, and expansion of data collected to include claimed reductions and other relevant data for reporting purposes. As a result, this bill would impact the department's programming, systems, processing and printing costs, which could be very costly.

Technical Considerations

On page 4, line 21, (g)(2)(B), and on page 9, line 15, (j)(2)(B), the paragraphs provide that the date the return is received will be determined by the FTB. Note that the return received date is provided for judicially and by statutory requirements. Therefore, this would create a new standard that would be different than other returns. We recommend removing these paragraphs for consistency of application within the R&TC.

Policy Concerns

The bill would provide that the date the LLC or corporation's return is received would be determined by the FTB, and that determination may not be reviewed in any administrative or judicial proceeding. This bill would restrict these entities from having the ability to request the review of this FTB determination, while all other entities have the ability make this request. Thus, this bill would provide inequity treatment for these LLCs and corporations. If that is not the author's intent, then the author may wish to amend the bill.

This bill would provide that a new single-owner corporation would be exempt from the minimum tax when they already would qualify for the first year minimum tax exemption. Thus, these corporations would not receive any benefit the first year, but would see a reduction in the following years.

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

LEGISLATIVE HISTORY

AB 2306 (Melendez, 2019/2020) would, under the 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. AB 2306 is currently scheduled for a hearing with the Assembly Revenue and Taxation Committee on March 23, 2020.

AB 308 (Muratsuchi, 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, and the LLC or corporation operates at a loss or ceases to operate, for taxable years beginning on or after January 1, 2020.

SB 349 (Portantino, 2019/2020), under the PITL and the CTL, would have modified the minimum franchise tax for corporations having less than $15 million in gross receipts and would have allowed an exemption from the annual tax or the minimum franchise tax for certain small business LLCs and corporations that were solely owned by a deployed member of the U.S. Armed Forces. SB 349 was vetoed by the governor whose veto message stated in part, "The intent of this bill 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 bill would be better addressed through the annual budget process."

AB 250 (Choi, 2019-2020) would have, under the CTL, modified the minimum franchise tax for corporations having less than $15 million in gross receipts, and under the PITL, would have retained the $800 minimum annual tax. 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, 2017/18) would have reduced the annual tax for LLCs that were small businesses, 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 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 significantly impact the department’s programming, systems, processing, and printing costs. As the bill continues to move through the legislative process, costs will be identified, and a budget change proposal will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

There would be a revenue loss to the general fund, but the amount is unknown.

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 data needed to determine the revenue from reducing the annual tax requirement for both single-member LLCs and single-owner corporations where the member/owner is of low to moderate income is not readily available. To determine the income level of the member/owner would require manual inspection of each taxpayer’s return. The resources needed to acquire this data are currently unavailable. Therefore, the department is unable to estimate the annual revenue loss.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE STAFF CONTACT

Elaine Segarra Warneke
Legislative Analyst, FTB
(916) 845-7746
elaine.warneke@ftb.ca.gov

Tiffany Christiansen
Revenue Manager, FTB
(916) 845-5346
tiffany.christiansen@ftb.ca.gov

Annette Kunze
Legislative Director, FTB
(916) 845-6333
annette.kunze@ftb.ca.gov