



Analysis of Original Bill

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Sponsor:

Bill Number: AB 308

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Introduced: January 29, 2019

Attorney: Shane Hofeling

Related Bills: See Legislative
History

Subject: Limited Liability Companies/Reduce Annual Tax For Micro Or Small Businesses/ Exempt From Annual Tax LLC Small Business Owned by Deployed Member of the U.S. Armed Forces

Summary

This bill would, under the Personal Income Tax Law (PITL), reduce the annual tax on a Limited Liability Company (LLC) doing business in California that is a microbusiness or a small business.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to help microbusiness and small business 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, 2019.

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

For taxable years beginning on or after January 1, 2019, this bill would reduce the annual tax for LLCs as follows:

- Microbusinesses would pay an annual tax of \$100.
- Small businesses would pay an annual tax of \$400.

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

“Small business” would mean an LLC with a total income from all sources derived from, or attributable to, the state of more than \$150,000, but no more than \$250,000.

This bill would also eliminate the provision that made inoperative for taxable years beginning on or after January 1, 2018, the exemption from the annual tax for certain small business LLCs that are solely owned by a deployed member of the Armed Forces.

Implementation Considerations

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

It is unclear for what taxable years the exemption from the annual tax for certain LLC's solely owned by a deployed member of the Armed Forces would apply. For clarity and to ensure consistency with the author's intent, this bill should be amended to specify the taxable years that would be exempt from the annual tax.

Legislative History

AB 364 (Calderon, 2019/2020) would reduce the annual tax for the first year for new, small business LPs or LLCs. AB 364 was referred to the Committee on Revenue and Taxation on February 7, 2019.

AB 1256 (Brough, 2017/2018) would have reduced the minimum franchise tax or annual tax for the first or second year for new, small businesses corporations, LLCs LLPs, and LPs. AB 1256 failed passage out the Assembly by the constitutional deadline.

AB 2510 (Muratsuchi, 2017/2018) would have allowed an LLC that is a microbusiness to pay a reduced annual tax of \$100, and reinstated the exemption from the annual tax for certain deployed military-owned small business LLCs. AB 2510 failed passage out of the Assembly by the constitutional deadline.

SB 248 (Morrell, 2017/2018) would have eliminated and reduced the minimum franchise tax or annual tax for the first six taxable years for new, small business corporations, LLCs, Limited Liability Partnership (LLP), and Limited Partnerships (LPs). SB 248 failed passage out of the Senate 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 passage out of the Assembly by the constitutional deadline.

AB 612 (Patterson, 2015/2016) would have reduced the annual tax to \$400 for the first year for new, small business LPs, LLCs, and LLPs, and reduced the minimum franchise tax to \$400 for the second year for new, small business corporations. AB 612 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, Illinois, Michigan, and Minnesota do not impose a minimum tax on corporations or partnerships.

Massachusetts imposes a \$456 minimum excise tax on corporations, including small business corporations, and imposes no minimum tax on partnerships.

New York imposes a minimum income tax of \$25 on most corporations, and a minimum annual filing fee of \$25 on certain partnerships.

Fiscal Impact

This bill would not significantly impact the department's costs.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 308 as Introduced January 29, 2019. Assumed Enactment after June 30, 2019.

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	- \$600
2020-2021	- \$430
2021-2022	- \$470

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 LLCs for the 2016 taxable year, it is estimated that in the 2019 taxable year approximately 530,000 LLCs would be subject to the annual tax under current law and would benefit from the reductions of the annual tax proposed in this bill. The estimated revenue loss from the reduction of the annual tax for micro business LLCs to \$100 and for small business LLCs to \$400, would be approximately \$350 million in taxable year 2019.

Current law allows a minimum franchise tax exemption to small businesses solely owned by deployed members of the Armed Forces, whose businesses operate 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 annual tax there would be a revenue loss of \$65,000.

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

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.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of a tax benefit by the Legislature.

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