



Analysis of Amended Bill

Author: Muratsuchi & Smith	Sponsor:	Bill Number: AB 308
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Subject: Exemption from Annual Tax and Minimum Franchise Tax for Small Business, Limited Liability Companies, and Corporations Owned by a Deployed Member of the U.S. Armed Forces

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow an exemption from the annual tax or the minimum franchise tax for certain small business Limited Liability Companies (LLCs) and corporations that are solely owned by a deployed member of the Armed Forces.

Recommendation – No position.

Summary of Amendments

The March 18, 2019, amendments added provisions to modify the minimum franchise tax provisions in the CTL, added sunset provisions in both the PITL and CTL, and added a reporting requirement.

The March 25, 2019, amendments deleted the provisions to modify the annual tax for small business and microbusiness LLCs, and further modified the reporting requirements.

This analysis replaces the department's analysis of the bill as introduced on January 29, 2019.

Reason for the Bill

The reason for the bill is to help small business LLCs and corporations solely owned by a deployed member of the United States Armed Forces succeed by providing an exemption from the annual tax or the minimum franchise tax under certain circumstances.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2019, and before January 1, 2029.

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. In addition to the annual tax, an annual fee based on the total income from all sources derived from or attributable to the state may apply.

This Bill

This bill would, under the PITL and CTL, replace the existing January 1, 2018, inoperative date with January 1, 2029, and re-establish for taxable years beginning on or after January 1, 2019, and before January 1, 2029, an exemption from the annual tax or minimum franchise tax as applicable, for LLCs and corporations that are small businesses that meet all of the following:

- Is solely owned by a deployed member of the United States Armed Forces,
- Is a small business, and
- Operates at a loss or ceases operation for the taxable year.

The following definitions would apply for purposes of the exemption:

- "Deployed" means being called to active duty or active service during a period when a Presidential Executive order specifies that the United States is engaged in combat or homeland defense. Deployed would specifically exclude temporary duty for the sole purpose of training or processing, or a permanent change of station.

- “Operates at a loss” means:
 - Expenses that exceeds receipts with respect to an LLC.
 - Negative net income as defined in Revenue and Taxation Code section 24341 with respect to a corporation.
- “Small business” means an LLC or a corporation with total income from all sources derived from, or attributable, to California of \$250,000 or less.

The Franchise Tax Board (FTB) would be allowed to promulgate regulations as necessary or appropriate, including defining “ceases operation.”

The FTB would be required, on or before January 1, 2021, and on or before January 1 annually thereafter through January 1, 2031, to submit a report to the Legislature on the performance of LLCs and corporations that are small businesses solely owned by a deployed member of the Armed Forces, that would include:

- The number of small business LLCs and corporations that are solely owned by a deployed member of the Armed Forces in the state,
- The number of individuals employed by these businesses, and
- The number of these businesses that close.

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 bill would be effective upon enactment, the exemption would apply to taxable years beginning on or after January 1, 2019, and before January 1, 2029, thus no exemption would be available for the 2018 taxable year. If the exemption is intended to apply to the 2018 taxable year, this bill should be amended.

This bill would require the department to expand data collection to include specified data on small business LLCs and corporations that are solely owned by a deployed member of the Armed Forces. Collecting this data would require the department to change its systems, forms, and processes, which could be costly.

The initial report required by this bill would be due on or before January 1, 2021. The department generally processes returns within six months of receipt. If the author’s intent is to have the report to the Legislature contain complete information for each taxable year, the due date of the report should be changed. For example, the extended due date for the taxable year ended December 31, 2019, may be as late as October 15, 2020, and the extended due date for a fiscal-year filer may be as late as September 15, 2021. Thus, the earliest that data from all 2019 returns could be included in a report would be approximately June 2022.

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 is currently referred to the Assembly Committee on Revenue and Taxation.

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

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 as amended on March 25, 2019, would have a revenue impact on the general fund, but the amount of the loss 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

Previous law allowed a minimum franchise tax and an annual tax exemption to small businesses solely owned by deployed members of the Armed Forces, whose businesses operated at a loss or ceased to exist. Because the FTB is unable to predict future deployment and business operations, the revenue impact of reinstating the exemptions 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 \$80,000.

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 subject to the PITL, including LPs and LLPs. Thus, this bill would provide differing treatment based solely on classification.

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