STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

Author: Muratsuchi, et al.	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 United States (U.S.) Armed Forces, and if double joining language becomes operative, modify the minimum franchise tax for corporations having less than $15 million in gross receipts.

Recommendation – No position.

Summary of Amendments

The September 6, 2019, amendments added double-joining language with SB 349 (Portantino).

As a result of the September 6, 2019, amendments, the "Effective/Operative Date," "This Bill," "Implementation Considerations," "Fiscal Impact" and "Economic Impact" sections of the department's analysis of the bill as amended June 13, 2019, have been revised. The remainder of that analysis still applies. The "Policy Concerns" section has been restated below for convenience.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment.

The provision exempting certain small business LLCs and corporations from the annual tax or minimum tax would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2030.

The modified minimum franchise tax provision would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025, if both this bill and SB 349:

1) Are enacted and become effective on or before January 1, 2020, and
2) Amend Revenue and Taxation Code (R&TC) section 17941, and
3) This bill is enacted after SB 349.

This Bill

This bill would, under the PITL and CTL, replace the existing January 1, 2018, inoperative date with January 1, 2030, and re-establish for taxable years beginning on or after January 1, 2020, and before January 1, 2030, 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 exceed 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.

This bill also contains double-joining language that would incorporate provisions from SB 349 (Portantino), modifying the minimum franchise tax imposed on corporations, based on gross receipts during the taxable year, as shown below, recasting the cross references in the annual tax provisions to retain the $800 minimum for entities subject to the annual tax, and requiring in uncodified law, the FTB to submit an annual report on the performance of small businesses affected by the bill's reduction in the minimum franchise tax to the Legislature, as specified.

The minimum franchise tax would be determined as follows:

Gross receipts less than $2,500,000	Gross receipts of $2,500,000 or more but less than $7,500,000	Gross receipts of $7,500,000 or more but less than $15,000,000	Gross receipts of $15,000,000 or more
$200	$400	$600	$800

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.

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, 2020, may be as late as October 15, 2021, and the extended due date for a fiscal-year filer may be as late as September 15, 2022. Thus, the earliest that data from all 2020 returns could be included in a report would be approximately June 2023.

Should the double-joining language become operative, the department would be required to replace the existing flat rate corporate minimum tax as a graduated amount based on gross receipts thus requiring significant systems, processes, and forms and instructions changes, and education and outreach efforts.

Fiscal Impact

Should the double-joining language become operative, staff estimates a cost of approximately $385,000 in fiscal year 2019-2020 and ongoing costs of $374,000 in fiscal year 2020-2021, $7,000 in fiscal year 2021-2022, and $4,000 in fiscal years 2022-2023 and

2023-2024 to develop, program, and test revisions to existing systems necessary to implement the reporting related to the reduced minimum franchise tax provision of this bill. The department will pursue a budget change proposal if necessary.

If the double-joining language fails to become operative, implementing 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 SB 308 as Amended September 6, 2019
Assumed Enactment by September 30, 2019

($ in Millions)

Fiscal Year	Revenue*
2019-2020	-$120
2020-2021	-$320
2021-2022	-$340

*These values include the revenue impact if the double-joining language that would incorporate provisions from SB 349 (Portantino) modifying the minimum franchise tax imposed on corporations, based on gross receipts during the taxable year, becomes operative.

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

This bill would specify that the amount of minimum franchise tax would be determined in accordance with the taxpayer's "gross receipts." Based on data from the FTB for tax years 2013 through 2016, it is estimated that in taxable year 2020 approximately 580,000 corporations would be impacted by the changes to the amount of the minimum franchise tax as proposed in this bill.

The estimated revenue loss from the proposed changes to the minimum franchise tax for C and S corporations would be approximately $315 million in the 2020 taxable year. This consists of minimum franchise tax that would no longer be paid, offset by measured tax. C and S corporate taxpayers must pay the measured tax only if it is more than the minimum franchise tax.

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

Previous law allowed a minimum franchise tax and an annual tax exemption to small businesses solely owned by deployed members of the U.S. Armed Forces, whose business operates at a loss or ceases 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's double-joining provision to reduce the minimum tax would provide a tax benefit for corporations under the CTL that would be unavailable to other business entities under the PITL, such as LPs, LLCs not classified as corporations, LLPs, charitable organizations, regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, financial asset securitization investment trusts, and qualified Subchapter S subsidiaries. Thus, if triggered, the double-joining language would provide differing treatment based solely on classification.

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