STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Obernolte | Sponsor: | Bill Number: AB 3233
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Attorney: Shane Hofeling | Related Bills: None

SUBJECT

Regulated Investment Company (RIC) Exempt-Interest Dividends

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would remove the requirement that a RIC can only pay tax exempt-interest dividends to its shareholders if at least 50 percent of the RIC's totals assets consist of California tax-exempt bonds ("50 percent asset test"). As a result, this bill would allow the RIC to pay tax exempt-interest dividends to its shareholders, regardless of the make-up of the RIC's assets.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for this bill is to allow taxpayers to receive exempt interest dividends on their investments.

ANALYSIS

This bill, under the PITL, would remove the provision that authorizes a RIC, as defined, to pay the exempt-interest dividends to its shareholders, only if 50 percent of the value of its total assets consists of obligations which, when held by an individual, are exempt from taxation by the state. Therefore, any dividend received by a shareholder from a RIC from obligations that would be tax-exempt if held by an individual would be tax-exempt to the shareholder, regardless of the percentage of tax-exempt assets held by the RIC.

In addition, the bill makes other nonsubstantive changes.

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, 2020.

Federal/State Law

Federal Law

Federal law states that if, at the close of each quarter of its taxable year, at least 50 percent of the value of the total assets of the RIC consists of tax-exempt obligations, then to the extent a dividend is from an obligation that would be tax-exempt if held by an individual, then the dividend received by the shareholder would also be a tax-exempt dividend.

State Law

Although California has stand-alone language for the taxation of RICs, California generally conforms to the federal RIC treatment. Current state law states that if, at the end of each quarter, a RIC has at least 50 percent of the funds' assets invested in obligations, which would also be exempt from tax if held by an individual, the tax exempt-interest portion of those dividends would also be tax-exempt in the hands of the RIC's shareholders. Federal and California obligations may be combined to meet the 50 percent asset test.

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.

If this bill is enacted in late September or October of 2020, the department would have developed the forms and instructions for the 2020 taxable year. Thus, the department may incur additional costs to develop alternative forms and instructions in the short time frame necessary to ensure they are available for taxpayers to comply with the reporting requirement.

For clarity, it is recommended that the bill be amended to specify an operative date for the changes.

Technical Considerations

None noted.

Policy Concerns

This bill would create additional differences between federal and California tax law, moving California further away from federal conformity, which would increase the complexity of California tax return preparation.

In addition, this bill may discourage investments in California tax-exempt obligations because there would no longer be a tax benefit for RIC shareholders for a RIC to invest in tax exempt obligations. Under current law, RICs are encouraged to hold at least 50 percent of the value of its assets in tax-exempt obligations so that their shareholders can recognize the benefit of receiving a tax-exempt dividend.

LEGISLATIVE HISTORY

AB 1432 (Perea, Chapter 490, Statutes of 2011) generally conformed to the RIC Modernization Act of 2010.

PROGRAM BACKGROUND

None noted.

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

This bill does not contain section 41 language.

Revenue Estimate

Estimated Revenue Impact of AB 3233 as Introduced February 21, 2020
Assumed Enactment after June 30, 2020

Based on the provisions in this bill, the Franchise Tax Board (FTB) is unable to determine an estimated revenue impact at this time.

Revenue Discussion

Determining the revenue impact of the bill would require knowing the number of California taxpayers who received tax exempt distributions from RIC, which due to willful neglect, and not reasonable cause, allowed the value of the tax–exempt assets to fall below 50 percent of the value of all assets at the close of each of three quarters in the past year.

Since it is difficult to predict the frequency and the value of future errors, the revenue impact to the General Fund is unknown. We anticipate that for every $1 million dollars of exempt-interest dividends received there would be a revenue loss of approximately $60,000.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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