



Analysis of Original Bill

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Sponsor:

Bill Number: AB 364

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Attorney: Shane Hofeling

Related Bills: See Legislative
History

Subject: Minimum Annual Tax: Exemption

Summary

This bill would, under the Personal Income Tax Law (PITL), exempt new Limited Partnerships (LP)s and new Limited Liability Companies (LLC)s, that are small businesses, from the payment of the annual tax for their first taxable year.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to promote economic vitality and job creation by providing new businesses a tax exemption during their first operative year.

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, 2020.

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.

This Bill

For taxable years beginning on or after January 1, 2020, this bill would create an exemption from the minimum annual tax for the first taxable year for an LP or LLC that is a new, small business doing business in this state and required to file a return under Section 18633.

The exemption would be inapplicable to an LP or LLC that reorganizes solely for the purpose of reducing its minimum tax, or fails to file a timely return.

For purposes of the exemption, this bill would define the following terms:

- “New limited partnership” means an LP that is formed on or after January 1, 2020, except for an LP that either:
 - Began business operations as, or acquired its business operations from, a sole proprietorship, an LLP, or any other form of business entity prior to beginning business operations, or
 - Acquired its business operations from an LP.
- “New limited liability company” means an LLC that is formed on or after January 1, 2020, except for an LLC that either:
 - Began business operations as, or acquired its business operations from, a sole proprietorship, an LLP, or any other form of business entity prior to beginning business operations,
 - Acquired its business operations from an LLC.
- “Small business” means an LP or LLC that has “gross receipts, less returns and allowances, reportable to this state,” for the taxable year, of \$50,000 or less.

- “Gross receipts, less returns and allowances, reportable to this state” means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of Section 25120,¹ and the gross receipts from the production of nonbusiness income, as defined in subdivision (d) of Section 25120.²

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.

Because the bill fails to specify otherwise, a return filed by the extended due date by an otherwise eligible LP or LLC would be considered timely filed and eligible for the exemption. If this is contrary to the author’s intent, the bill should be amended.

Technical Considerations

The bill uses the terms “minimum tax” and “minimum annual tax” interchangeably when the correct reference is “annual tax.” For consistent use of terminology and internal harmony within the PITL, this bill should be amended to refer to “annual tax” throughout.

Subdivision (f) of Section 17935 and subdivision (g) of Section 17941 need to be amended where the term, “notwithstanding subdivision (a), for taxable years” appears, as it should be “notwithstanding subdivision (a) and (b), for taxable years” for clarity and consistency.

Legislative History

AB 308 (Muratsuchi, 2019/2020) would reinstate the exemption from the annual tax and the minimum franchise tax for certain deployed military-owned small business LLCs and corporations. AB 308 is pending before the 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.

¹ “Business income” means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.

² “Nonbusiness income” means all income other than business income.

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, LLP, and LPs. SB 248 failed passage out 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 AB364 as Introduced February 4, 2019.
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$19
2020-2021	-\$32
2021-2022	-\$33

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 income data for LPs and LLCs for the 2015 taxable year, it is estimated that in the 2020 taxable year there would be approximately 1,300 first year LPs and 38,000 first year LLCs with gross receipts of \$50,000 or less that would be subject to the annual tax under current law and would benefit from the first year annual tax exemption. This would result in an estimated revenue loss of \$32 million in the 2020 taxable year.

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 LPs, and LLCs subject to the PITL, that would not be provided to LLPs. Thus, this bill would provide differing tax treatment to taxpayers based solely on their classification or form of organization.

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