STATE OF CALIFORNIA
Franchise Tax Board

Analysis of Original Bill

Author: Committee on Budget	Sponsor: None	Bill Number: AB 85
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SUBJECT

Budget Trailer Bill - State Taxes and Charges

SUMMARY

This bill would do the following:

Sections 6 and 14: For taxable years 2020, 2021, and 2022, under the California Personal Income Tax Law (PITL), requires that business tax credits reduce tax liability by no more than $5 million, and under the Corporation Tax Law (CTL), requires that tax credits reduce tax liability by no more than $5 million. This provision extends the credit carryover period for credits disallowed under this provision.

Sections 7 and 15: PITL section 17053.95 and CTL section 23695, extends the new motion picture production credit carryover period from six to nine years.

Sections 8 and 16: Suspends the use of Net Operating Loss (NOL) deductions. The suspension does not apply to taxpayers with a net business income or modified adjusted gross income of less than $1 million under the PITL or for taxpayers with income subject to tax under the CTL of less than $1 million for taxable years 2020, 2021, and 2022. This provision also extends the carryover period for NOL deductions disallowed under this provision.

Sections 9, 10, 11 and 24: A first year exemption from the annual tax for Limited Partnerships (LPs), Limited Liability Companies (LLCs), and Limited Liability Partnerships (LLPs) is allowed under the PITL.

Section 13: The credit related to new advanced strategic aircraft (Strategic Aircraft Credit) to reduce tentative minimum tax is allowed under the CTL.

Sections 12, 17, 18 and 19: For the Individual Shared Responsibility Penalty, modifies collection priority; limits the maximum monthly penalty for a responsible individual with a household size of five or more; corrects references to "responsible individual" and "applicable household member;" and exempts the Franchise Tax Board's (FTB) regulations from the Administrative Procedures Act requirements until January 1, 2022.

This is the department's first analysis of the bill and only addresses the provisions that impact the department.

RECOMMENDATION

No position

REASON FOR THE BILL

The reason for the bill is to make various statutory changes related to implementing the 2020 Budget Act.

ANALYSIS (All Provisions)

Economic Impact – Summary Revenue Table ($ in Millions)

Fiscal Year	2020-2021	2021-2022	2022-2023
Provision No. 1: Limit use of business tax credits	+$2,000	+$1,500	+$900
Provision No. 2: Extension of new film credit carryover period	N/A	N/A	-$1.3
Provision No. 3: Suspension of NOL deductions	+$1,800	+$1,300	+$380
Provision No. 4: LP, LLC and LLP annual tax 1st year exemption	-$33	-$95	-$105
Provision No. 5: Strategic Aircraft Credit	N/A	N/A	N/A
Provision No. 6: Individual Shared Responsibility Penalty	N/A	N/A	N/A
Total $ in Millions	+$3,767	+$2,705	+$1,173.7

Effective/Operative Date (All Provisions)

As a provision within a bill providing for appropriations related to the Budget Bill, these provision would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2020.

ANALYSIS

Sections 6 and 14: Limits the amount of business tax credits that may reduce tax for three years.

This provision would make the following changes under the PITL and CTL:

- Limit the amount of allowable business credits, as specified, to $5 million for taxable years beginning on or after January 1, 2020, and before January 1, 2023. For taxpayers included in a combined report, this determination is made at the group level.
- Exclude the Low Income Housing Credit (LIHC) from the credit limitation.
- Increase the carryforward period for credits subject to the limitation by the number of taxable years the credit was not allowed by operation of this limitation.
- Specify that amounts included in an election under Revenue and Taxation Code (R&TC) section 6902.5 to apply film credits against qualified sales and use tax would not be included in the credit limitation.
- Exempts guidance issued by the FTB from the requirements of the Administrative Procedures Act.

For purposes of the PITL credit limitation, the $5 million credit limit would apply to "business credits" as defined. In addition to excluding the LIHC, the definition of business credits would specifically exclude the credits relating to earned income, young child, household and dependent care, adoption costs, renters, personal exemption, joint custody head of household and for care of dependent parent, senior head of household, and excess contributions of unemployment compensation. Business credits, as limited, would be required to be applied against the tax due before the excluded credits.

Federal/State Law

Current federal and state law do not specify a dollar limit on the total amount of all credits that can reduce the tax otherwise due similar to the limit this provision would impose.

Implementation Considerations

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 1452 (Assembly Committee on Budget, Chapter 763, Statutes of 2008) among other things, limited to an applicable amount the "business credits" that could reduce the tax due for taxable years beginning on or after January 1, 2008, and before January 1, 2010.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 85 as Amended June 10, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	+$2,000
2021-2022	+$1,500
2022-2023	+$900

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

The revenue impact as shown in the table above has been provided by the Department of Finance.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

ANALYSIS

Sections 7 and 15: Extends the Film Credit's Carryover Period

This provision would extend the carryover period for the Film credit from six years to nine years and make several nonsubstantive technical changes.

Federal/State Law

Federal Law

There is no current federal law comparable to the state's Film credit.

State Law

Under the Film credit in R&TC sections 17053.95 and 23695, the state law allows a credit that is administered by the California Film Commission for taxable years beginning on or after January 1, 2016.

The Film credit is calculated by multiplying the qualified expenditures for a production of a motion picture in California, as certified by the California Film Commission, by an applicable credit percentage. The carryover period for the Film credit is six years or until the credit is exhausted, whichever comes first.

Implementation Considerations

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

SB 878 (Committee on Budget and Fiscal Review, Chapter 456, Statutes of 2018) modified the Legislativ e Analyst Office's reporting requirement, clarified the California Film Commission's (Commission's) authority to allocate the credit, and appropriated funds to the Commission, as specified.

SB 951 (Mitchell and Portantino), (2017/2018) would have allowed a credit to a qualified taxpayer for qualified expenditures for the production of a qualified motion picture in California. SB 951failed to pass out of the Senate by the constitutional deadline.

AB 2936 (Nazarian),(2017/2018) would have extended the California Motion Picture and Television Production Credit (Motion Picture Credit) to 2024-2025 fiscal year under the PITL and CTL. AB 2936 failed to pass out of the Assembly by the constitutional deadline.

AB 286 (Nazarian, 2015/2016) would have modified the Motion Picture Credit. AB 286 failed to pass out of the Assembly by the constitutional deadline.

AB 1839 (Gatto, et al., Chapter 413, Statutes of 2014) created the New Motion Picture Credit under the PITL and CTL that was available for allocation by the CA Film Credit Commission for fiscal years 2015-2016 through 2019-2020, inclusive. New Motion Picture Credits in excess of the tax liability may be carried over for six years, if necessary, until the credit has been exhausted.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This provision 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 85 as Amended June 10, 2020
Assumed Enactment by September 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	N/A
2021-2022	N/A
2022-2023	-$1.3

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

The revenue impact as shown in the table above has been provided by the Department of Finance.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

ANALYSIS

Sections 8 and 16: **Suspension of Net Operating Loss (NOL) Deductions**

This provision would suspend NOL deductions for taxable years 2020, 2021, and 2022. The suspension of NOLs would not apply to a taxpayer:

- Under the PITL, with modified adjusted gross income or net business income of less than $1,000,000.
- Under the CTL, with income subject to tax of less than $1,000,000.

This provision would also extend the NOL carryover period by one year for NOLs incurred in taxable year 2021, two years for NOLs incurred in taxable year 2020, and three years for NOLs incurred in taxable years beginning before 2020.

"Modified adjusted gross income" would mean the amount required to be shown as adjusted gross income on the federal tax return for the same taxable year[1] without taking into consideration the NOL deduction.[2]

"Net business income" means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S corporation), income from rental activity, and income attributable to a farming business.

Federal/State Law

Federal Law

An NOL generally means the amount by which a taxpayer's business deductions exceed its gross income. A taxpayer generally may deduct in a taxable year an NOL carried to such year.

Prior to the Coronavirus Aid, Relief, and Economic Security Act[3] (CARES Act)

For NOLs arising in taxable years beginning after December 31, 2017, the NOL deduction generally is limited to 80 percent of taxable income determined without regard to the NOL deduction. Excess losses generally may be carried forward indefinitely, but not back, and carryovers of such NOLs to other taxable years are adjusted to take account of the 80-percent taxable income limitation. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.

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[1] R&TC section 17024.5(h)(2).
[2] Internal Revenue Code (IRC) section 172.
[3] Coronavirus Aid, Relief, and Economic Security Act (HR748; Pub. L. 116-136).

NOLs arising in taxable years beginning before January 1, 2018, are not subject to the 80-percent taxable income limitation. Further, such NOLs remain subject to the 20-year carryover limitation and the relevant carryback rules in effect for taxable years beginning before January 1, 2018.

A taxpayer with NOL carryovers to a taxable year from both taxable years beginning before 2018 and taxable years beginning after 2017 computes its tax liability as follows. First, the taxpayer may deduct an NOL in the amount of its pre-2018 NOL carryovers without limitation. Second, the taxpayer may deduct an additional NOL equal to the lesser of (1) its post-2017 NOL carryovers or (2) 80 percent of the excess (if any) of the taxpayer's taxable income (before any NOL deduction attributable to post-2017 NOL carryovers) over the NOL deduction attributable to pre-2018 NOL carryovers.

Changes made by the CARES Act

The CARES Act suspended the application of the 80-percent taxable income limitation for taxable years beginning after December 31, 2017, and before January 1, 2021.[4] The 80-percent taxable income limitation continues to apply in the case of any taxable year beginning after December 31, 2020. The 80-percent taxable income limitation was also eliminated for NOLs arising in taxable years beginning after December 31, 2017, that were generated in taxable years beginning on or before December 31, 2017, and carried to such a taxable year.[5]

The CARES Act also modified the rules regarding carrybacks for NOLs arising in 2018, 2019, and 2020.[6] Specifically, any NOL arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, may be carried back to the five taxable years preceding the taxable year of such loss.[7]

State Law

Over the years, there have been several changes to the California NOL provisions. In general, California allows a taxpayer to calculate an NOL in accordance with federal rules, but has not conformed to the federal changes that apply to taxable years beginning after December 31, 2017.

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[4] Coronavirus Aid, Relief, and Economic Security Act (HR748; Pub. L. 116-136).
[5] IRC section 172(a)(2). IRC section 172(a)(2)(A) provides that NOLs arising in taxable years beginning before January 1, 2018, carried to a taxable year beginning after December 31, 2020, are not subject to the 80-percent taxable income limitation.
[6] IRC section 172(b)(1)(D).
[7] See IRC section 172(b)(1)(D)(i). Pursuant to IRC section 172(b)(2), any NOL carryback must be carried to the earliest taxable years to which such loss may be carried. NOLs eligible for the five-year carryback period include, for example, those arising with respect to farming losses, which would otherwise be subject to a two-year carryback period. See, *e.g.*, IRC section 172(b)(1)(B).

NOLs attributable to taxable years beginning on or after January 1, 2008, may be carried forward 20 years. For NOLs attributable to taxable years beginning before January 1, 2013, and after December 31, 2018, NOL carrybacks are unavailable. California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2013, and before January 1, 2019, with modifications.

California law provides that losses generated in taxable years beginning on or after January 1, 2013, and before January 1, 2019, are allowed to be carried back to the two preceding taxable years.

The carryback was phased in as follows:

- 50-percent of the NOL generated in taxable years beginning in 2013 is eligible for a two-year carryback.
- 75-percent of the NOL generated in taxable years beginning in 2014 is eligible for a two-year carryback.
- 100-percent of the NOL generated in taxable years beginning in 2015 through 2018 is eligible for a two-year carryback.

For taxable years beginning in 2008 and 2009, California suspended the NOL carryover deduction. Taxpayers continued to compute and carryover their NOL during the suspension period. However, individuals with a net business income of less than $500,000, and corporations with taxable income of less than $500,000, were not affected by the NOL suspension rules.

Also, for taxable years beginning in 2010 and 2011, California suspended the NOL carryover deduction. Taxpayers continued to compute and carryover NOLs during the suspension period. However, individuals with a modified adjusted gross income of less than $300,000, and corporations with net income less than $300,000, were not affected by the NOL suspension rules.

The carryover period for any NOL or NOL carryover, for which a deduction is disallowed because of the 2008-2011 suspension, is extended by:

- One year for losses incurred in taxable years beginning on or after January 1, 2010, and before January 1, 2011.
- Two years for losses incurred in taxable years beginning on or after January 1, 2009, and before January 1, 2010.
- Three years for losses incurred in taxable years beginning on or after January 1, 2008, and before January 1, 2009.
- Four years for losses incurred in taxable years beginning before January 1, 2008.

Implementation Considerations

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 91 (Burke, Chapter 39, Statutes of 2019) disallowed the carryback of NOLs that were incurred in taxable years beginning on or after January 1, 2019, for individual and corporate taxpayers.

AB 2855 (Brough, 2017/2018) would have established an application for a tentative refund process, similar to the federal process for obtaining a tentative refund based on an NOL carryback, and specified the trigger date for the statute of limitations and interest accrual applicable to an NOL carryback. AB 2855 failed to pass out of the Senate Appropriations Committee by the constitutional deadline.

AB 154 (Ting, Chapter 359, Statutes of 2015) conformed to the federal NOL rules that allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year.

AB 1984 (Harkey, 2013/2014) would have conformed to the federal provisions that allow a taxpayer with NOL carrybacks to obtain a tentative refund of taxes paid in prior tax years by filing a tentative carryback adjustment application, and allow a corporation to apply to extend the time for payment of taxes for the immediately preceding taxable year. AB 1984 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

AB 2408 (Skinner, 2011/2012) would have eliminated the two-year carryback of NOLs so that NOLs could only be carried forward. AB 2408 failed to pass out of the Senate by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 85 as Amended June 10, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	+$1,800
2021-2022	+$1,300
2022-2023	+$380

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

The revenue impact as shown in the table above has been provided by the Department of Finance.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

ANALYSIS

Sections 9, 10, 11, and 24: LP, LLC, and LLP Annual Tax First Year Exemption

This provision would, under the PITL, eliminate the annual tax for LPs, LLCs, not classified as corporations, and LLPs, that organize, register, or file with the Secretary of State on or after January 1, 2021, and before January 1, 2024, for their first taxable year.

This bill would make the above LP, LLC, and LLP, first year tax exemptions contingent on an appropriation of $1 or more to the FTB to fund the costs of administration.

In addition, Section 24 of this bill contains language that would not be included in the numbered sections of the R&TC, and provides that the intent of the Legislature to apply the requirements of Section 41 of the R&TC to this provision.

The Legislature finds and declares as follows:

1) The goal of this provision is to help and reduce costs for first-year California small businesses. Existing law imposes an annual minimum franchise tax of $800 on every corporation, and an annual minimum tax of $800 on every LP, LLC, not classified as a corporation, and LLP, which may be difficult to afford for first-year businesses. As such, these taxes may stifle the economic growth and job creation and may inhibit the formation of many small businesses.
2) The performance indicator for this provision is the number of first-year businesses that are affected by the bill.
3) Despite the general disclosure provisions under the R&TC, the bill would require the FTB, on or before January 1, 2023, and on or before January 1 each year thereafter through, and including, January 1, 2024, to submit an annual report to the Legislature on the performance of first-year corporations, LPs, LLCs, and LLPs in the state using the data in paragraph (2). The required report would be submitted pursuant to Section 9795 of the Government Code.

Federal/State Law

Federal Law

Federal law does not require payment of an annual tax for LPs, LLCs, or LLPs.

State Law

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 of $800. [8]

[8] R&TC section 23153.

In general, under the PITL, LPs, LLCs, not classified as corporations, and LLPs are subject to an annual tax equal to the $800 minimum franchise tax.[9]

Every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, is exempt from the minimum franchise tax for its first taxable year. This exemption is inapplicable to a corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax. In addition, the exemption does not apply to LPs, LLCs not classified as corporations, and LLPs, charitable organizations, Royal Institution of Chartered Surveyors (RICS), Real Estate Investment Trusts (REITs), Real Estate Mortgage Conduit((REMIC), and Financial Asset Securitization Investment Trust (FASIT).

For taxable years beginning on or after January 1, 2020, an LLC or corporation that is a small business solely owned by a deployed member of the United States (U.S.) Armed Forces is not subject to the annual tax or minimum franchise tax for any taxable year that the owner is deployed and the LLC or corporation operates at a loss or ceases operation.

Implementation Considerations

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 2929 (Arambula & Muratsuchi, 2019/2020) would have, under the PITL and the CTL, reduced the annual tax for certain single-member LLCs and the minimum franchise tax for certain single-owner corporations to provide that these taxpayers would not be subject to the tax in their first taxable year, and for the following four years, the tax would incrementally increase annually by two hundred dollars ($200), subject to limitations that would have been administered by the FTB on a first-come-first-served basis. This bill is currently in the committee process.

[9] R&TC sections 17935, 17941, and 17948.

AB 308 (Muratsuchi, Chapter 421, Statutes of 2019), under the PITL and the CTL, allowed an exemption from the annual tax or the minimum franchise tax for certain small business LLCs and corporations that are solely owned by a deployed member of the U.S. Armed Forces, and the LLC or corporation operates at a loss or ceases to operate, for taxable years beginning on or after January 1, 2020, and before January 1, 2030.

SB 349 (Portatino, 2019/2020), under the CTL, would have modified the minimum franchise tax for corporations having less than $15 million in gross receipts and allow an exemption from the annual tax or the minimum franchise tax for certain small business LLCs and corporations that are solely owned by a deployed member of the U.S. Armed Forces. This bill was vetoed by Governor Newsom on October 13, 2019. The reason given for the veto was that the proposal would be better addressed through the annual budget process.

AB 2410 (Grayson, 2017/2018) would have reduced the annual tax for LLCs that were small businesses, as defined, within the first two years of operation from $800 to $400. AB 2410 failed to pass out of the Assembly by the constitutional deadline.

AB 2625 (Lopez, 2015/2016) would have reduced the minimum franchise and annual tax on certain new microbusiness entities. AB 2625 failed to pass out of the Assembly by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

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

ECONOMIC IMPACT

On or before January 1, 2023, and on or before January 1 each year thereafter through January 1, 2024, the FTB shall submit an annual report to the Legislature on the performance of first year corporations, LLCs, LPs and LLPs in the state using the number of first- year businesses that are affected by the act.

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 85 as Amended June 10, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	**Revenue**
2020-2021	-$33
2021-2022	-$95
2022-2023	-$105

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.

Because the impact of current economic circumstances is unknown, this estimate is subject to change.

Revenue Discussion

Based on FTB data for LLCs, LLPs and LPs, it is estimated that in the 2021 taxable year the estimated revenue loss from the exemption of the $800 annual tax for first year LLCs, LLPs and LPs would be approximately $33 million in taxable year 2020.

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

LEGAL IMPACT

None noted.

APPOINTMENTS

None provided.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

ANALYSIS

Section 13: Strategic Aircraft Credit

This provision would, under the CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2026, allow the Strategic Aircraft Credit to reduce the tax below the tentative minimum tax.

Federal/State Law

Federal Law

The federal corporate alternative minimum tax (AMT) was repealed by the federal Tax Cuts and Jobs Act for tax years beginning after December 31, 2017.

State Law

Under current state law, corporations are subject to both the regular tax and the AMT if their tentative minimum tax is greater than their regular tax. Under current law a number of credits are specifically allowed to reduce the tentative minimum tax for purposes of determining the AMT. The Strategic Aircraft Credit may not reduce the tentative minimum tax under current law.

Implementation Considerations

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

AB 2389 (Fox, et al., Chapter 116, Statutes of 2014) among other things, under the CTL, created the Strategic Aircraft Credit.

SB 718 (Roth, et al., Chapter 189, Statutes of 2014) modified the provisions of the Strategic Aircraft Credit to, among other things, expand eligibility for the credit by modifying the definition of "qualified taxpayer" to include a prime contractor awarded a prime contract.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Not applicable.

Revenue Discussion

The revenue impact has been provided by the Department of Finance.

This bill does not change revenue to the state during the current budget window, but could increase the amount of credit available to taxpayers in future years.

LEGAL IMPACT

None noted.

APPOINTMENTS

None provided.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

ANALYSIS

Sections 12, 17, 18 and 19: Individual Shared Responsibility Penalty

These provisions would make the following changes:

1) *Payment application priority (Section 12).* This provision would allow the Individual Shared Responsibility Penalty to be collected along with other FTB administered penalties.
2) *Sets a cap on the Individual Shared Responsibility Penalty (Section 17).* This provision limits the monthly penalty for a responsible individual with an applicable household size of five or more to the maximum monthly penalty for a responsible individual with an applicable household size of five individuals.
3) *Inclusion of appropriate references to "responsible individual" and "applicable household member" (Section 18).* This provision clarifies references to "responsible individual" and "applicable household member" for purposes of administering the exemption from the penalty for responsible individuals whose cost of coverage exceeds the prescribed affordability threshold.
4) *Inclusion of regulations in exemption from the requirements of the Administrative Procedures Act (Section 19).* This provision provides authorization for the FTB to adopt regulations necessary and appropriate to implement the Individual Shared Responsibility Penalty without application of the requirements prescribed by the Administrative Procedures Act.

Federal/State Law

Federal Law

Existing federal law, the Patient Protection and Affordable Care Act (PPACA), enacts various health care coverage market reforms as of January 1, 2014. PPACA generally requires an individual, and any dependents of the individual, to maintain minimum essential coverage (MEC), also known as qualifying health care coverage, and, if an individual fails to maintain MEC, PPACA imposes on the individual taxpayer a penalty. This provision is referred to as the individual mandate. The federal Tax Cuts and Jobs Act set the payment associated with the individual shared responsibility requirement of the PPACA to zero beginning in 2019.

State Law

<u>Individual Shared Responsibility Penalty</u>

In 2019, SB 78 added Part 32 (commencing with Section 61000) to Division 2 of the R&TC, which imposes the Individual Shared Responsibility Penalty on applicable individuals who fail to maintain MEC as required by Title 24 (commencing with Section 100700) of the Government Code, unless they qualify for an exemption.

The penalty will be imposed on a responsible individual for failure by the responsible individual, applicable spouse, or applicable dependent to enroll in and maintain MEC. The penalty imposed will be included with a responsible individual's return.

The penalty is equal to the lesser of either of the following amounts, and is computed as follows:

1) The sum of the monthly penalty amounts for months in the taxable year during which one or more failures occurred.
2) An amount equal to one-twelfth of the state average premium for qualified health plans that have a bronze level of coverage for the applicable household size involved, and are offered through the Exchange for plan years beginning in the calendar year with or within which the taxable year ends, multiplied by the number of months in which a failure occurred.

For purposes of computing (1) above, the monthly penalty amount for any month during which a failure occurred is an amount equal to one-twelfth of the greater of either of the following amounts:

- An amount equal to the lesser of either of the following:
    - The sum of the applicable dollar amounts for all applicable household members who failed to enroll in and maintain MEC during the month unless they did not maintain MEC for a continuous period of three months or less.
    - Three hundred percent of the applicable dollar amount determined for the calendar year during which the taxable year ends.
- An amount equal to 2.5 percent of the excess of the responsible individual's applicable household income for the taxable year over the amount of gross income that would trigger the responsible individual's requirement to file a state income tax return based on the applicable filing threshold for the taxable year.

The applicable dollar amount for adults is six hundred ninety-five dollars ($695), and is indexed to the California Consumer Price Index. If an applicable individual has not attained 18 years of age as of the beginning of the month, the applicable dollar amount with respect to that individual for that month shall be equal to one-half of the applicable dollar amount for the 2020 calendar year, the applicable dollar amount is $750.

The FTB may, in consultation with the Exchange, adopt regulations that are necessary and appropriate to implement the Individual Shared Responsibility Penalty.

Implementation Considerations

None noted.

Technical Considerations

None noted.

Policy Concerns

None noted.

LEGISLATIVE HISTORY

SB 78 (Committee on Budget and Fiscal Review, Chapter 38, Statutes of 2019) established the Individual Shared Responsibility Penalty applicable to California residents and their dependents who fail to obtain and maintain MEC for each month beginning January 1, 2020.

PROGRAM BACKGROUND

Federal Individual Shared Responsibility Provision. The PPACA's individual mandate requires that individuals maintain MEC or make a shared responsibility payment for noncompliance. Exemptions from the individual mandate are granted for a variety of reasons related to income, affordability of coverage, and federally defined hardship.

The payment for not maintaining MEC is either a flat dollar amount or a percentage of household income above the annual tax-filing threshold, whichever is greater. In late 2017, the federal Tax Cuts and Jobs Act set the payment associated with the individual shared responsibility requirement of the PPACA to zero beginning in 2019.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Not applicable.

Revenue Discussion

The revenue impact has been provided by the Department of Finance.

The Individual Shared Responsibility Penalty has no fiscal impact scored in the budget but allows FTB to avoid the approximately $15 million to $20 million General Fund cost it would incur to update its accounting system to prioritize Individual Shared Responsibility Penalty debt after non-interest bearing debt.

LEGAL IMPACT

None noted.

APPOINTMENTS

None provided.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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