



Analysis of Original Bill

Author: Portantino

Sponsor:

Bill Number: SB 349

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Introduced: February 19, 2019

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Related Bills: See Legislative
History

Subject: Minimum Franchise Tax/Reduce for Corporations

Summary

This bill would, under the Corporation Tax Law (CTL), modify the minimum franchise tax for corporations having less than \$15 million in gross receipts and, under the Personal Income Tax Law (PITL), retain the \$800 minimum annual tax.

Recommendation – No position.

Reason for the Bill

The reason for this bill is to provide much needed relief for small businesses in California.

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

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. Taxpayers must pay the minimum franchise tax unless their measured franchise tax is greater. For taxable years beginning on or after January 1, 1997, the measured tax is imposed on net income at a rate of 8.84 percent. Thus under current law, only corporations with net income 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).

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. It also does not apply to limited

partnerships (LPs); limited liability companies (LLCs) not classified as corporations, limited liability partnerships (LLPs), charitable organizations, regulated investment companies (RICs), real estate investment trusts (REITs), real estate mortgage investment conduits (REMICs), financial asset securitization investment trusts, and qualified Subchapter S subsidiaries.

Under existing state law, the annual tax on LPs, LLCs not classified as corporations, LLPs, RICs, REITs, REMICs, and S corporations, is set at \$800 by reference to the minimum franchise tax.

This Bill

For taxable years beginning on or after January 1, 2020, this bill would modify the minimum franchise tax imposed on corporations based on gross receipts as shown below and recast the cross references in the annual tax provisions to retain the \$800 minimum for entities subject to the annual tax. The minimum franchise tax would be determined as follows:

<u>Gross receipts less than \$2,500,000</u>	<u>Gross receipts of \$2,500,000 or more but less than \$7,500,000</u>	<u>Gross receipts of \$7,500,000 or more but less than \$15,000,000</u>	<u>Gross receipts of \$15,000,000 or more</u>
\$200	\$400	\$600	\$800

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, corporations otherwise eligible for a reduced minimum franchise tax whose measured tax based on net income exceeds the reduced minimum franchise tax amount would be required to pay the larger measured tax amount. If this is contrary to the author's intent this bill should be amended to specify that the reduced minimum franchise tax is controlling.

The bill is silent on when gross receipts must be received for purposes of determining whether a reduced minimum franchise tax would apply. For example, would the amount of gross receipts received during the taxable year be used? A reasonable estimate of gross receipts for the taxable year? To avoid disputes between taxpayers and the department and to ensure consistency with the author's intent, this bill should be amended.

Legislative History

AB 250 (Choi, 2019/2020), substantially similar to this bill, would modify the minimum franchise tax for corporations having less than \$15 million in gross receipts and retain the \$800 minimum annual tax. AB 250 is currently referred to the Assembly Revenue and Taxation Committee.

AB 2131 (Melendez, 2017/2018) would have reduced the minimum franchise tax from \$800 to \$400. AB 2131 failed to pass out of the Assembly by the constitutional deadline.

AB 2410 (Grayson, 2017/2018) would have reduced the annual tax for LLCs that are a small business, 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.

SB 1417 (Cannella, 2017/2018), substantially similar to this bill, would have modified the minimum franchise tax for corporations having less than \$15 million in gross receipts and would retain the \$800 minimum annual tax. SB 1417 failed to pass out of the Assembly by the constitutional deadline.

AB 328 (Grove, 2015/2016) would have exempted new veteran owned small corporations and LLCs from the minimum franchise or annual tax, as applicable. AB 328 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.

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, Michigan, and Minnesota do not impose a minimum tax on business entities.

Illinois, Massachusetts, and New York impose a minimum tax on corporations, but they lack a graduated tax based on gross revenue similar to the one proposed in this bill.

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 would result in the following revenue loss:

Estimated Revenue Impact of SB 349 as Introduced February 19, 2019
Assumed Enactment after June 30, 2019

(\$ in Millions)

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

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 Franchise Tax Board for tax years 2013-2016, 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.

Policy Concern

This bill 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, RICs, REITs, REMICs, financial asset securitization investment trusts, and qualified Subchapter S subsidiaries. Thus, this bill would provide differing treatment based solely on classification.

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