STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Portantino Bill Number: SB 349

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 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.

Reason for the Bill

The reason for this bill is to provide tax relief for certain small businesses in California.

Effective/Operative Date

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

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.

The provision exempting certain small businesses and corporations from the annual tax or minimum franchise tax would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2030, if both this bill and AB 308:

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 AB 308.

State Law

Unless specifically exempted by statute, every corporation that is organized or qualified to do business in California, 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 x 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); 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, and before January 1, 2025, this bill would, under the CTL, modify the minimum franchise tax imposed on corporations, based on gross receipts during the taxable year, 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:

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

In uncodified law, this bill would require the FTB to submit a report to the Legislature on or before January 1, 2020, and on or before each January 1 annually thereafter through January 1, 2025, on the performance of small businesses affected by the bill's reduction in the minimum franchise tax.

This bill also contains double-joining language that would incorporate provisions from AB 308 (Muratsuchi & Smith), re-establishing 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 solely owned by a deployed member of the U.S. Armed Forces that operates at a loss or ceases operation for the taxable year.

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 failed to pass out of 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

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 for this bill. The department will pursue a budget change proposal if necessary.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 349
Assumed Enactment after June 30, 2019

($ in Millions)

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

*These values do not include the revenue impact of reinstating the 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 cease to exist. There is a revenue impact on the general fund, but the amount of the loss is unknown.

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 would provide a tax benefit for corporations under the CTL that would be unavailable to other business entities under the PITL, such as limited partnerships, LLCs not classified as corporations, limited liability partnerships, 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, this bill would provide differing treatment based solely on classification.

Appointments

None.

Votes

Location	Date	Yes Votes	No Votes
Concurrence	September 11, 2019	40	0
Assembly Floor	September 10, 2019	78	1
Senate Floor	May 22, 2019	38	0

Legislative Staff Contact

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