



Analysis of Amended Bill

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Sponsor:

Bill Number: SB 626

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Amended: July 2, 2019

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Related Bills: See Legislative
History

Subject: Exemption from Minimum Franchise Tax and Annual Tax for Small Businesses Owned by a Deployed Member of the U.S. Armed Forces

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), temporarily exempt small businesses owned by a deployed member of the U.S. Armed Forces from the annual tax or the minimum franchise tax.

Recommendation – No position.

Summary of Amendments

The July 2, 2019, amendments added provisions that would under the PITL, temporarily exempt from the annual tax Limited Liability Companies (LLCs) that are small businesses owned by a deployed member of the U.S. Armed Forces, require an annual report to the legislature, and specify evaluation metrics for purposes of the report.

This analysis replaces the department's analysis of the bill as amended April 4, 2019, and April 25, 2019.

Reason for the Bill

The reason for the bill is to provide an exemption from the minimum franchise tax or the annual tax for small businesses owned by a deployed member of the United States Armed Forces.

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, and before January 1, 2029.

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 (currently \$800).

This Bill

This bill would, under the PITL and the CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2029, exempt from the annual tax or minimum franchise tax, as applicable, LLCs and corporations that meet all of the following:

- Is solely owned by a deployed member of the United States Armed Forces,
- Is a small business, and
- Operates at a loss or ceases operation for the taxable year.

The following definitions would apply for purposes of the exemption:

- “Deployed” means being called to active duty or active service during a period when a Presidential Executive order specifies that the United States is engaged in combat or homeland defense. Deployed would specifically exclude temporary duty for the sole purpose of training or processing, or a permanent change of station.
- “Operates at a loss” means:
 - Expenses that exceeds receipts with respect to an LLC.
 - Negative net income as defined in Revenue and Taxation Code section 24341 with respect to a corporation.
- “Small business” means a corporation or LLC with total income from all sources derived from, or attributable, to California, of \$250,000 or less.

The provisions enacting the exemptions would become inoperative for taxable years beginning on or after January 1, 2029.

In uncodified law, this bill would require the Franchise Tax Board (FTB), to submit a report to the Legislature, on or before January 1, 2020, and every January 1, annually thereafter through January 1, 2029, that includes data on the amount of small business corporations and LLCs that are affected by the exemption this bill would allow.

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.

The initial report required by this bill would be due on or before January 1, 2020. The specified taxpayers would generally use the exemption beginning with the tax year ending December 31, 2020, and would file the returns before October 15, 2021. The department generally processes returns within six months of receipt. If the author's intent is to have the report to the Legislature contain complete information for each taxable year, the due date of the report should be changed to March 2022 or later.

Technical Considerations

The bill includes a reporting requirement for the FTB in uncodified law. For ease of reference, it is recommended the bill be amended to include these provisions in law.

The bill's uncodified provision uses the undefined phrases "limited liability corporation" and "limited liability corporations," and should be amended to use the defined terms "limited liability company" and "limited liability companies" respectively for consistent use of income and franchise tax terminology.

Legislative History

AB 308 (Muratsuchi, et al., 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 has been referred to the Senate Committee on Appropriations.

AB 364 (Calderon, 2019/2020) would reduce the annual tax for the first year for new, small business Limited Partnerships (LPs) or LLCs. AB 364 has been referred to the Assembly Revenue and Taxation Committee.

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 Limited Liability Partnerships (LLPs), and LPs. AB 1256 failed passage out the Assembly by the constitutional deadline.

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.

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.

AB 2671 (Cook, et al., Chapter 394, Statutes of 2010), similar to this bill, provided a temporary exemption from the annual tax and the minimum franchise tax for certain small business LLCs and corporations that are solely owned by a deployed member of the Armed Forces. The exemption provisions became inoperative for taxable years beginning on or after January 2, 2018.

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. No exemption from this fee for a veteran owned business was identified.

New York imposes a minimum income tax of \$25 on most corporations, and a minimum annual filing fee of \$25 on certain partnerships. No exemption from this fee for a veteran owned business was identified.

Fiscal Impact

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

Economic Impact

Revenue Estimate

This bill as amended on July 2, 2019, would have 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

Previous law allowed a minimum franchise tax and an annual tax exemption to small businesses solely owned by deployed members of the Armed Forces, whose business operates at a loss or cease 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 either the annual tax or the minimum franchise tax there would be a revenue loss of \$80,000.

Policy Concerns

This bill would provide a tax benefit for specified LLCs subject to the PITL that would be unavailable to other business types subject to the PITL, including LPs and LLPs. Thus, this bill would provide differing treatment based solely on classification.

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