STATE OF CALIFORNIA
**Franchise Tax Board**

# Bill Analysis

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| Author: Ramos | Sponsor: | Bill Number: AB 632 |
| | Related Bills: See Legislative History | Introduced: February 12, 2021 |

## SUBJECT

Reduced Annual & Minimum Franchise Tax for Businesses with less than $15 Million in Gross Receipts

## SUMMARY

This bill, under the Corporation Tax Law (CTL), would reduce the $800 minimum franchise tax for corporations, and, by reference, the annual tax for limited partnerships (LPs), limited liability partnerships (LLPs), or limited liability companies (LLCs) not classified as corporations, based on gross receipts.

## RECOMMENDATION

No position.

## SUMMARY OF AMENDMENTS

Not applicable.

## REASON FOR THE BILL

The reason for this bill is to provide small businesses economic relief from the effects of COVID-19.

## ANALYSIS

For taxable years beginning on or after January 1, 2022, and before January 1, 2027, this bill would reduce the annual tax for LPs, LLPs, or LLCs not classified as corporations, and the minimum franchise tax for corporations that are organized or qualified to do business, or doing business in the state (whether organized in-state or out-of-state), based on gross receipts for the taxable year.

This bill, under the CTL, by reference in the Personal Income Tax Law (PITL), would calculate the annual tax for LPs, LLPs, and LLCs, not classified as corporations, as well as the minimum franchise tax for corporations, based on their gross receipts by setting different annual tax amounts, depending on the entity's gross receipts for the taxable year.

The annual tax and the minimum franchise tax would be:

- If gross receipts are less than $2.5 million, $200.
- If gross receipts are equal to or more than $2.5 million, but less than $7.5 million, $400.
- If gross receipts are equal to or more than $7.5 million, but less than $15 million, $600.
- If gross receipts are equal to or more than $15 million, $800.

Section 6 of this bill contains language, not included in the numbered sections of the Revenue and Taxation Code (RTC), that provides the intent of the Legislature to comply with the requirements of RTC section 41, including:

- The goal of this bill is to help and reduce costs for California small businesses.
- Performance indicators would be the number of small businesses that are affected by the bill.
- On or before January 1, 2023, and on or before January 1 each year thereafter through and including January 1, 2028, the Franchise Tax Board (FTB) would be required to submit an annual report, pursuant to Section 9795 of the Government Code, to the Legislature on the effect of the tax reduction created by this bill.
- The reporting requirements of this bill would be treated as an exception to the disclosures rules under RTC section 19542.

*Effective/Operative Date*

As a tax levy, this bill would be effective immediately upon enactment, with the gross receipts-based changes to the annual tax and minimum franchise tax being specifically operative for taxable years beginning on or after January 1, 2022, and before January 1, 2027.

*Federal/State Law*

*Federal Law*

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

*State Law*

Unless specifically exempted by statute, every corporation, and LP, LLP, or LLC classified as a 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.

In general, LPs, LLPs, and LLCs, not classified as corporations, that are organized or qualified to do business, or doing business in this state (whether organized in-state or out-of-state) are subject to an annual tax equal to the $800 minimum franchise tax.

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.

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.

In addition, every LP, LLP and LLC, not classified as a corporation, that organizes, registers, or files with the California Secretary of State on or after January 1, 2021, and before January 1, 2024, is exempt from the annual tax for its first taxable year.

*Implementation Considerations*

The department has identified the following implementation considerations, and is available to work with the author's office to resolve these and other considerations that may be identified.

This bill would require the department to provide a report on the effect of the tax reduction created by this bill by January 1, 2023. However, the department would not have the specific data for the 2022 taxable year until after July 2024. In addition, the Section 41 reporting requirements only include the effect on corporations. The author may wish to amend the bill to change the reporting due date to allow the department to collect the necessary data, and to clarity that the reporting requirements apply to corporations as well as other entities impacted by this bill.

*Technical Considerations*

For clarity, in Sections 17935(a), 17941(a), and 17948(a) related to the reference to Section 23153, consider amending the bill to specify, "…amount specified in subparagraph<u>s</u> (A) <u>*and (B)*</u> of paragraph (1) of subdivision (d) of Section 23153."

*Policy Considerations*

None noted.

## LEGISLATIVE HISTORY

AB 91 (Valladares, 2021-2022), under the PITL, would reduce the annual tax for LPs, LLPs, and LLCs not classified as corporations, that are small businesses or microbusinesses, as defined, from $800 to $400 or $200, respectively. In addition, under the CTL, this bill would reduce the minimum franchise tax for corporations that are small businesses or microbusinesses, as defined, from $800 to $400 or $200, respectively. AB 91 was referred to the Assembly Revenue and Taxation Committee on January 11, 2021.

AB 85 (Committee on Budget, Chapter 8, Statutes of 2020), under the PITL, provided a first year exemption from the annual tax for LPs, LLPs, and LLCs not classified as corporations.

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.

AB 250 (Choi, 2019-2020) would have, under the CTL, modified the minimum franchise tax for corporations having less than $15 million in gross receipts, and under the PITL, would have retained the $800 minimum annual tax. AB 250 did not pass out of the Assembly by the constitutional deadline.

AB 2306 (Melendez, 2019/2020) would have, under the CTL, repealed the $800 corporate minimum franchise tax for corporations doing business in the state for taxable years beginning on or after January 1, 2020. AB 2306 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 2929 (Arambula and 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); with a limitation of minimum tax reduction of one hundred million dollars ($100,000,000) per taxable year and annual tax reduction of one hundred million dollars ($100,000,000) per taxable year, administered by the FTB on a first-come-first-served basis. AB 2929 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

SB 349 (Portantino, 2019/2020), under the PITL and the CTL, would have modified the minimum franchise tax for corporations having less than $15 million in gross receipts and would have allowed an exemption from the annual tax or the minimum franchise tax for certain small business LLCs and corporations that were solely owned by a deployed member of the U.S. Armed Forces. SB 349 was vetoed by the governor whose veto message stated in part, "The intent of this bill is to provide tax relief for smaller California businesses and to encourage economic growth. Both are important goals which I support, and helping small businesses is certainly a priority I share with the Legislature. However, this bill would be better addressed through the annual budget process."

AB 2131 (Melendez, 2017/2018) would have reduced the minimum franchise tax from $800 to $400. AB 2131 did not pass out of the Assembly by the constitutional deadline.

AB 2410 (Grayson, 2017/18) 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 did not pass out of the Assembly by the constitutional deadline.

**PROGRAM BACKGROUND**

None noted.

**FISCAL IMPACT**

This bill would impact the department's systems, resulting in programming and processing revisions. The department's costs to implement this bill have yet to be determined. As the bill continues to move through the legislative process, costs will be identified.

**ECONOMIC IMPACT**

*Revenue Estimate*

The following estimate is revised to account for additional information related to the underlying data applied in this estimate.

This bill would result in the following revenue loss.

Revised Estimated Revenue Impact of AB 632 as Introduced February 12, 2021
Assumed Enactment after June 30, 2021

($ in Millions)

| Fiscal Year | Revenue |
|---|---:|
| 2021-2022 | -$210 |
| 2022-2023 | -$650 |
| 2023-2024 | -$700 |

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 data from the FTB, it is estimated that approximately 1.2 million entities would be impacted by the provisions proposed in this bill. For the 2022 taxable year, the estimated loss would be approximately $650 million.

**LEGAL IMPACT**

None noted.

**APPOINTMENTS**

None noted.

**SUPPORT/OPPOSITION**

To be determined.

**ARGUMENTS**

To be determined.

**LEGISLATIVE CONTACT**

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