



Bill Analysis

Author: Cooley

Sponsor:

Bill Number: AB 820

Related Bills: See Legislative History
Amended: March 18, 2021

SUBJECT

Sales Factor & Income Exclusion for Interest - Banks & Financials

SUMMARY

This bill would do the following:

Provision No. 1 ~ Income Exclusion of Qualified Interest Income

This provision, under the Corporation Tax Law (CTL), would allow banks and financial corporations, which generate business income solely from or attributable to sources within California, a gross income exclusion for qualified interest income, as provided, that is generated from qualified loans made to California small businesses.

Provision No. 2 ~ Sales Factor Exclusion of Qualified Interest Income

This provision, under the CTL, would provide that banks and financial corporations, which generate business income from or attributable to sources within and without California, would also exclude the interest from the sales factor.

Provision No. 3 ~ FTB Reporting Requirements

This provision would require the Franchise Tax Board (FTB) to provide any available data related to the provisions of this bill to the Legislative Analyst's Office (LAO), as provided.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 18, 2021, amendments removed provisions of the bill related to a nonsubstantive change to the Health and Safety Code, relating to economic development, and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for the bill is to encourage financial institutions to issue loans to small businesses in the state.

ANALYSIS

Analysis Provision 1:

Income Exclusion of Qualified Interest Income (Section 1)

For taxable years beginning on or after January 1, 2021, Provision 1 of this bill, under the CTL, would provide a qualifying bank or financial corporation a gross income exclusion for the amount of qualified interest income generated by qualified loans made to qualified small businesses.

For purposes of this provision, the following definitions would apply:

- A) "Qualified interest income" would mean interest income that a qualified taxpayer generates on a qualified loan during the taxable year.
- B) "Qualified loan" would mean a loan of one million dollars (\$1,000,000) or less that is made by the qualified taxpayer to a qualified small business on or after March 15, 2020, but prior to January 1, 2025.
- C) "Qualified small business" would mean a business that meets the following requirements:
 - 1) Has 50 or fewer full-time or full-time equivalent employees on the date of the loan application.
 - i. "Full-time equivalent" would mean the workload of the full-time equivalent job is comparable to one year of full-time work.
 - 2) Experienced an annual loss in net revenue of 10 percent (10%) or more since March 15, 2020.
 - 3) Is located in the state.
- D) "Qualified taxpayer" would mean a bank or financial corporation that generates business income that is solely derived from or attributable to sources within this state, and is therefore not subject to apportionment.
 - 1) A "bank" generally includes a national banking association and any "bank" operated by any receiver, liquidator, referee, trustee or other officers or agents appointed by any court, or an assignee for the benefit of creditors.
 - 2) A "financial corporation" generally means a corporation that predominantly deals in money or moneyed capital in substantial competition with the business of national banks.

Federal/State Law

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations.

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 defines the term "full-time equivalent" to mean the workload of the full-time equivalent job is comparable to one year of full-time work. Generally, this term would be more specific. For clarity, the author may wish to amend the bill.

The bill also includes in the definition of a qualified small business, one with 50 or fewer employees. Additionally, the definition includes an "annual loss in net revenue of 10 percent (10%) or more since March 15, 2020." For clarity, the author may wish to add a date to measure the "loss" in revenue, for example by comparing gross receipts or net income from March 15, 2020, to December 31, 2020. Additionally, for ease of implementation, "net revenue" should be replaced with a figure reported on the tax return, such as "gross receipts" or "net income."

Technical Considerations

For consistency of terminology, the following changes are recommended:

- SECTION 1, Section 24313.5(b)(2), "Qualified interest income" means interest revenue that a qualified taxpayer generates on a qualified loan during the applicable taxable year." should be replaced with "Qualified interest income" means interest ~~incomerevenue~~ that a qualified taxpayer generates on a qualified loan during the ~~applicable~~-taxable year."
- SECTION 1, Section 24313.5(b)(4), "'Qualified small business' means a business that meets both of the following requirements:..." should be replaced with "'Qualified small business' means a business that meets ~~both of~~ the following requirements:..."

Policy Considerations

None noted.

LEGISLATIVE HISTORY

No legislation similar to this provision of the bill has been identified.

PROGRAM BACKGROUND

None noted.

LEGAL IMPACT

None noted.

Analysis Provision 2:

Sales Factor Exclusion of Qualified Interest Income (Section 2)

Provision 2 of this bill, under the CTL, for taxable years beginning on or after January 1, 2021, would provide that for qualifying banks or financial corporations the amount of qualified interest income generated by qualified loans made to qualified small businesses would also be excluded from the sales factor.

For purposes of this provision, the following definitions would apply:

- A. "Qualified interest income" would mean interest income that a qualified taxpayer generates on a qualified loan during the taxable year and that would be subject to apportionment.
- B. "Qualified loan" would mean a loan of one million dollars (\$1,000,000) or less that is made by the qualified taxpayer to a qualified small business on or after March 15, 2020, but prior to January 1, 2025.
- C. "Qualified small business" would mean a business that meets the following requirements:
 - 1) Has 50 or fewer full-time or full-time equivalent employees on the date of the loan application.
 - i. "Full-time equivalent" would mean the workload of the full-time equivalent job is comparable to one year of full-time work.
 - 2) Experienced an annual loss in net revenue of 10 percent (10%) or more since March 15, 2020.
 - 3) Is located in the state.
- D. "Qualified taxpayer" would mean a bank or financial corporation that generates income that is derived from or attributable to sources within and without this state, and is therefore subject to apportionment.

- 1) A “bank” generally includes a national banking association and any “bank” operated by any receiver, liquidator, referee, trustee or other officers or agents appointed by any court, or an assignee for the benefit of creditors.
- 2) A “financial corporation” generally means a corporation that predominantly deals in money or moneyed capital in substantial competition with the business of national banks.

Federal/State Law

Federal Law

No provision comparable in federal law.

State Law

Under California law, corporations deriving income from sources both within and outside California are required to measure their tax liability by reference to their income derived from or attributable to sources within California. To determine the portion of total income that is attributable to California, the apportionment and allocation method is used.

In addition, under California law, all affiliated United States and foreign entities comprising a single trade or business are viewed for certain purposes as a whole called a “unitary group.” The business income of all the affiliates that comprise a unitary group is apportioned and reported to California on a single report known as the “combined report.” The apportionment method only applies when a corporation operating in California derives income from sources both within and outside California. The apportionment method does not apply to a corporation operating wholly within California. In addition, a corporation would only be required to file in a “combined report” if it is unitary with another corporation, and at least one of the unitary corporations derives income from sources both within and outside California.

The apportionment method uses a formula to calculate the amount of a unitary group’s total income that was generated from the unitary group’s activities in California. This formula is comprised of a single sales factor that measures the activity of a unitary group in the state. There is an exception for qualified business activities in agriculture, extraction, savings and loans, and banking. The apportionment formula for these businesses is comprised of four components that measure the activity of the unitary group in the state: property, payroll, and double-weighted sales. The unitary group’s California business income is then apportioned among the members that are taxable in California. Each member retains a separate tax identity and liability.

In addition, when a taxpayer receives income that is partially or completely excluded from the measure of income or franchise tax, the activities related to that income would also be excluded for purposes of the apportionment factor. (FTB Legal Ruling 2006-01, dated April 28, 2006, Apportionment Factor Treatment of Exempt Income.) This bill would codify the holding of that ruling with respect to the qualified taxpayers under this provision.

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 defines the term "full-time equivalent" to mean the workload of the full-time equivalent job is comparable to one year of full-time work. Generally, this term would be more specific. For clarity, the author may wish to amend the bill.

The bill also includes in the definition of a qualified small business, one with 50 or fewer employees. Additionally, the definition includes an "annual loss in net revenue of 10 percent (10%) or more since March 15, 2020." For clarity, the author may wish to amend the bill to add a date to measure the "loss" in revenue, for example by comparing gross receipts or net income from March 15, 2020, to December 31, 2020. Additionally, for ease of implementation, "net revenue" should be replaced with a figure reported on the tax return, such as "gross receipts" or "net income."

Technical Considerations

The amendment to Section 25128.1 to exclude the qualified interest income from the sales factor is unnecessary as the definition of "qualified taxpayer" includes only taxpayers that are not subject to apportionment.

For consistency of terminology, the following changes are recommended:

- SEC. 2, Section 25128.1(b)(2), the term "Qualified interest income" means interest revenue that a qualified taxpayer generates on a qualified loan during the applicable taxable year and that would be subject to apportionment under subdivision (b) of Section 25128 but for the application of this section." should be replaced with "Qualified interest income" means interest ~~incomerevenue~~ that a qualified taxpayer generates on a qualified loan during the ~~applicable~~ taxable year and that would be subject to apportionment under subdivision (b) of Section 25128 but for the application of this section."
- SEC. 2, Section 253128.1(b)(4), "'Qualified small business' means a business that meets both of the following requirements:..." should be replaced with "'Qualified small business' means a business that meets ~~both of~~ the following requirements:..."

Policy Considerations

None noted.

LEGISLATIVE HISTORY

No legislation similar to this provision of the bill has been identified.

PROGRAM BACKGROUND

None noted.

LEGAL IMPACT

None noted.

ANALYSIS

Analysis Provision 3:

FTB Reporting Requirements (Section 3)

For purposes of Section 41, the detailed performance indicators to measure whether the tax benefits of the bill meet the goals and objectives of the bill include the number of banks and financial corporations excluding qualified interest income from gross income, the number of banks and financial corporations excluding qualified interest income from the apportionment factor, and the amount of qualified interest income excluded from business income apportionment factor.

The LAO would be required to collaborate with the FTB to analyze whether the tax benefits meet the goal, purpose, and objectives of this bill. The LAO may request information from the FTB, and the FTB would be required to provide any available data as requested by the LAO. The LAO would report their analysis to the Legislature, in compliance with Government Code section 9795, by December 1, 2025.

To allow the necessary FTB reporting to the LAO, the bill provides an exception to the provisions of Revenue and Taxation Code (RTC) section 19542, disclosure prohibition of confidential taxpayer information.

Federal/State Law

Existing California state laws require the FTB to report certain information to the California Legislature or other state agencies, as directed. Additionally, for both federal and state purposes, the disclosure of any confidential taxpayer information is prohibited, except as specifically authorized by statute.

Implementation Considerations

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

The bill would require the FTB to provide data related to the performance indicators to the LAO that would be required to be reported to the Legislature by December 1, 2025. However, the FTB would not have the specific data for all applicable tax years by the required reporting date. The earliest the FTB can provide data for a tax year is generally one year after the extended due date of the return for banks and financial corporations. For example, the extended due date for the 2024 tax year would generally be November 15, 2025; thus, the FTB would not have reporting data until December 2026 for the last applicable tax year. The author may wish to amend the bill to change the due date of the reporting requirement to allow the department to collect the necessary data for all applicable tax years.

Technical Considerations

This provision of the bill includes a reporting requirement for the FTB in SEC. 3. For ease of reference, it is recommended that the bill be amended to include these provisions within the relevant sections of the RTC, e.g., Sections 24313.5 and 25128.1.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

No legislation similar to this provision of the bill has been identified.

PROGRAM BACKGROUND

None noted.

LEGAL IMPACT

None noted.

Effective/Operative Date (All Provisions)

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2021.

FISCAL IMPACT (All Provisions)

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 (All Provisions)

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 820 as amended on March 18, 2021
Assumed Enactment after June 30, 2021

(\$ in Millions)

Fiscal Year	Revenue
2021-2022	-\$370
2022-2023	-\$300
2023-2024	-\$260

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.

APPOINTMENTS (All Provisions)

None provided.

SUPPORT/OPPOSITION (All Provisions)

None noted.

ARGUMENTS (All Provisions)

None noted.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov