



Analysis of Original Bill

Author: McGuire & Caballero Sponsor:

Bill Number: SB 104

Related Bills: See Legislative History
Introduced: January 5, 2021

SUBJECT

Small Business Relief Act (SBRA)

SUMMARY

This bill would do the following:

Section 1, Revenue and Taxation Code (R&TC) Part 10.4, SBRA:

This section, would create the SBRA, and would, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, allow a limited partnership (LP), a limited liability partnership (LLP), a limited liability company (LLC) taxed as a partnership, and an S corporation to pay an additional elective tax, at the entity level.

Section 2, R&TC Section 17132.9:

This section, under the Personal Income Tax Law (PITL), would not include in the gross income of an individual, who is a partner, member, or shareholder of an LP, an LLP, an LLC, or an S corporation that makes an annual election to pay additional elective tax authorized by the bill, the partner, member, or shareholder's pro rata share of the elective tax amount paid by the entity for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to provide tax relief to individuals, who are partners, members, and shareholders of small businesses facing unprecedented economic hurdles due to COVID-19.

ANALYSIS

Analysis Section 1, SBRA:

Elective Tax at Entity Level

This section would create the SBRA under newly created Part 10.4. The section would, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, allow a qualified taxpayer doing business in this state, as defined by Section 23101, and required to file a return under Section 18633 (partnership returns), to annually elect to pay an elective tax according to or measured by its net income computed at the rate of _____ percent upon the basis of its net income for the last preceding taxable year. (The bill currently has a “blank” space for the percent, rather than a number.)

The elective tax authorized by this bill would be in addition to, and not in place of, any other tax required to be paid under the PITL or the Corporation Tax Law (CTL).

The collection and administration of this elective tax would be governed by the provisions of the Administration of Franchise and Income Tax Law (AFITL) unless expressly superseded by the provisions of this bill.

The election to pay the elective tax authorized by this part would be made at the entity level, and all partners, members and shareholders would be bound by the election for the taxable year.

For purposes of Section 1, the following definitions would apply:

- 1) “Qualified taxpayer” means an entity that meets both of the following requirements:
 - a) The entity is taxed as a partnership or “S” corporation under Sections 17935, 17941, 17948, or 23802.
 - b) The partners, members, or shareholders in that taxable year are exclusively individuals.
- 2) “Qualified taxpayer” would be determined at the entity level and cannot be a taxpayer included in a combined reporting group.

The elective tax authorized by this section would be due and payable on an original and timely filed return.

This section would not change any filing requirements for a qualified taxpayer under the PITL or the AFITL.

The section would allow the Franchise Tax Board (FTB) to prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of this section without having to comply with the requirements of the Administrative Procedures Act.

If enacted, Part 10.4 would remain in effect only until December 1, 2026, and as of that date would be repealed.

Effective/Operative Date

This bill would be effective January 1, 2021, and applicable to taxable years beginning on or after January 1, 2021, and before January 1, 2026.

Federal/State Law

Federal Law

Federal law, prior to 2018, allowed individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. Certain other expenses for the production of income and certain employee business expenses were considered miscellaneous itemized deductions and only the portion that exceeded 2 percent of adjusted gross income could be deducted. Also, itemized deductions were further limited for high-income taxpayers.

Federal law, for taxable years beginning on or after January 1, 2018, under the Tax Cuts and Jobs Act, changed several itemized deductions, including:

- Suspending both the deduction for miscellaneous itemized deductions and the overall limitation on itemized deductions for high-income taxpayers for taxable years beginning after December 31, 2017, and before January 1, 2026.
- Limiting the total deduction for state and local income, sales and property taxes (SALT) to \$10,000 (\$5,000 if married filing separate).

The Internal Revenue Service (IRS) issued Notice 2020-75, dated November 9, 2020, which provides that the Department of Treasury and the IRS intend to issue regulations clarifying that tax payments made at the entity level would not be subject to the SALT deduction limitation applicable to partners and shareholders, who itemize deductions. Specifically, the announcement said the proposed regulations would:

“...clarify that State and local income taxes imposed on and paid by a partnership or an S corporation on its income are allowed as a deduction by the partnership or S corporation in computing its non-separately stated taxable income or loss for the taxable year of payment, and therefore are not subject to the State and local tax deduction limitation for partners and shareholders who itemize deductions.”

The Notice provides that pass-through entities can pay SALT at the entity level, and the tax deduction that flows through to the individual partners and shareholders will not be subject to the individual SALT limitation for itemized deduction purposes.

State Law

State law generally conforms to federal law as of the “specified date” of January 1, 2015, with modifications, allowing individuals to deduct certain expenses, such as medical expenses, charitable contributions, interest, and taxes, as itemized deductions. State law retains the deduction for SALT, miscellaneous itemized deductions, and the limitation for high-income taxpayers.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional considerations may be identified as the bill moves through the legislative process. Department staff is available to work with the author’s office to resolve these and other considerations that may be identified.

The section refers to a qualified taxpayer that is required to file under R&TC section 18633 (partnership returns). For clarity, the bill should also refer to R&TC sections 18633.5 and 18601 to include LLCs and S corporations, respectively.

Section 19900(a) provides that the elective tax would be computed based on the net income for the last preceding taxable year. If the author’s intent is to determine the income based on the current taxable year, the author may want to amend the bill. In addition, Section 19900(b)(1) provides that the elective tax authorized by this bill would be in addition to, and not in place of, any other tax required to be paid under the PITL or the CTL. The author may wish to amend the bill to include any tax *and fee* that would be required to be paid under the PITL and CTL.

The section does not state whether the election available under this part would be an irrevocable election. If this is the intent of the author for the election to be irrevocable for the taxable year of the election, the bill should be amended.

The section defines qualified taxpayer to mean an entity that is taxed as a partnership or S corporation. General partnerships do not pay tax under the PITL, and there is no reference to LLCs. For clarity of intent, the author may want to include explicit reference to general partnerships, by including a reference to R&TC section 17851 in the definition of “qualified taxpayer,” and include a reference to LLCs in addition to partnerships and S corporations.

The section provides that the FTB may prescribe rules, guidelines, procedures, or other guidance to implement this section. However, the bill does not include the adoption of regulations. For clarity and ease of administration, the author may want to amend the bill to include FTB’s ability to prescribe regulations.

Technical Considerations

For clarity, the author may wish to amend the bill to insert the rate of the elective tax under Section 19900(a), and to amend Section 19002(a)(2) to read, "The partners, shareholders, or members of the entity in that taxable year are exclusively individuals."

For consistency of terminology, the following changes are recommended:

In section 19900(b)(3), replace, "Unless the context otherwise requires, the definitions set forth in this part and those in Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001) govern the construction of this part." with "Unless otherwise provided in this Part, the definitions set forth in this part and those in Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001) shall apply."

In section 19902(b), replace, "'Qualified taxpayer' shall not include taxpayers in a combined reporting group,..." with "'Qualified taxpayer' shall not include taxpayers included in a combined reporting group,..."

Policy Considerations

One of the goals of the provisions of this bill is to provide tax relief to small businesses. If the election to pay the elective tax would be allowed to be made by all LPs, LLPs, LLCs, and S corporations, this may exceed the intended goal of "small business." The author may want to consider defining small business for purposes of Part 10.4 that would be added by this bill and restrict the tax election only to small businesses as so defined.

Because the election would be required to be made at the entity level, the provision in Section 19900(c) that states, "All partners, shareholders, and members shall be bound by the decision of the entity made with respect to this part for that taxable year." is not necessary.

LEGISLATIVE HISTORY

No legislation similar to the provisions of this bill have been identified.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill would impact the department's systems, resulting in programming, processing and form revisions as well as the need for taxpayer outreach. The department's costs to implement both sections of this bill are estimated to be \$1,500,000 for fiscal year

2021-2022, and estimated on-going annual costs of \$1,200,000. The department will pursue a budget change proposal if necessary.

ECONOMIC IMPACT

Revenue Estimate

A revenue estimate cannot be completed until the technical consideration related to the elective tax rate discussed in the Section 1, SBRA, has been addressed.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

Analysis Section 2:

R&TC Section 17132.9

Section 2 of this bill, under the PITL, would allow a qualified taxpayer, to not include in their gross income an amount equal to the qualified amount paid by a qualified entity for the taxable year.

For purposes of Section 2, the following definitions would apply:

- 1) "Qualified taxpayer" means an individual who is a partner, member, or shareholder of a qualified entity.
- 2) "Qualified amount" means an amount equal to the qualified taxpayer's pro rata share of the amount of elective tax paid by a qualified entity.
- 3) "Qualified entity" means an entity authorized, and elected, to pay the elective tax, as described in Section 1.

A qualified taxpayer can be a resident, nonresident or part-year resident, and would not be eligible for the Earned Income Tax Credit if their income eligibility results if the income allowed by this bill is not included in gross income.

This section would not change any filing requirements for a qualified taxpayer under the PITL or the AFITL.

For purposes of complying with Section 41, the Legislature finds and declares that the goal of this exclusion is to provide tax relief to small businesses facing unprecedented economic hurdles due to COVID-19.

If enacted, this section would remain in effect only until December 1, 2026, and as of that date would be repealed.

Effective/Operative Date

This bill would be effective January 1, 2021, and applicable to taxable years beginning on or after January 1, 2021, and before January 1, 2026.

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.

Neither federal nor state law allows a taxpayer to not include in their gross income an amount similar to the amount that would be provided by this bill.

Implementation Considerations

None noted.

Technical Considerations

The section has a typographical error in Section 17132.9(e), line 27 of the bill, "...economic hurtles due to COVID-19." should be "...economic hurdles due to COVID-19."

Policy Considerations

Section 17132.9(b)(3)(B) would provide that a qualified taxpayer may be a resident, nonresident, or part-year resident. This provision of the bill would generally apply, absent an express limitation. As such, this provision is unnecessary and can be removed.

LEGISLATIVE HISTORY

No legislation similar to the provisions of this bill have been identified.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill would impact the department's systems, resulting in programming, processing and form revisions as well as the need for taxpayer outreach. The department's costs to implement both sections of this bill are estimated to be \$1,500,000 for fiscal year 2021-2022, and estimated on-going annual costs of \$1,200,000. The department will pursue a budget change proposal if necessary.

ECONOMIC IMPACT

Revenue Estimate

A revenue estimate cannot be completed until the technical consideration related to the elective tax rate discussed below in Section 1, SBRA, has been addressed.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov