



Bill Analysis

Author: Ta

Sponsor:

Bill Number: AB 778

Related Bills: See Legislative
History

Introduced: February 13, 2023

SUBJECT

Annual Tax and Minimum Franchise Tax Exemptions for Eligible Businesses

SUMMARY

For taxable years beginning on or after January 1, 2023, this bill would, under the Personal Income Tax Law (PITL), exempt limited partnerships (LPs), limited liability partnerships (LLPs), and limited liability companies (LLCs) not classified as corporations, from the annual tax until the first taxable year that it has gross receipts of \$20,000 or more. In addition, under the Corporation Tax Law (CTL), this bill would provide a similar exemption from the minimum franchise tax.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to relieve the financial burden of the annual tax and the minimum franchise tax for new small businesses in California.

ANALYSIS

This bill would provide an exemption from the annual tax and minimum franchise tax for taxable years beginning on or after January 1, 2023. Under the PITL, LPs, LLPs, and LLCs not classified as corporations, would not be required to pay the annual tax until the first taxable year in which the LP, LLP, or LLC not classified as a corporation, has gross receipts of \$20,000 or greater. Additionally, under the CTL, corporations would not be required to pay the minimum franchise tax until the first taxable year in which the corporation has gross receipts of \$20,000 or greater.

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The bill provides that the goal, purpose, or objective of the bill is to relieve the financial burden for new small businesses in California, and that the performance indicator for the Legislature to use when measuring whether the bill meets this goal is the number of registered new small and microbusinesses in California.

This bill would require the Franchise Tax Board (FTB) to report to the Assembly Committee on Revenue and Taxation and the Senate Committee on Governance and Finance the number of new businesses in California not subject to the annual tax or minimum franchise tax pursuant to these exclusions. The FTB would be required to file this report in compliance with the requirements of Government Code section 9795. This report would be due on or before January 1, 2029.

The Revenue and Taxation Code (RTC) section 41 reporting requirements would be treated as an exception to the general prohibition against disclosure of confidential taxpayer information.

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, 2023.

Federal/State Law

Federal Law

Federal law does not require payment of an annual tax or minimum franchise 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.

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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 (US) 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.

Under RTC section 41, legislation that would create a new tax expenditure, which includes a credit, deduction, exclusion, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the tax benefit.

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.

If the 2023 taxable year is the taxpayer's first taxable year, and the taxpayer's gross receipts exceed \$20,000, there is a conflict between whether the first-year exemption would apply or the requirement to pay pursuant to these new amendments. The author may wish to amend the bill to clarify.

Technical Considerations

For consistency in terminology within the RTC, it is recommended that the phrase, "shall not be required to pay" be replaced with "shall not be subject to the tax imposed under this section" throughout the bill.

The Section 41 reporting requirements would include information relating to the annual tax but excludes information relating to the minimum franchise tax. In addition, the "new small and microbusinesses in California" is used rather than referring to businesses with gross receipts below \$20,000.

Policy Considerations

This bill does not provide a sunset date, which would generally allow periodic review of the effectiveness of the tax law change.

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LEGISLATIVE HISTORY

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 US 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 91 (Valladares, 2021/2022), under the PITL, would have reduced the annual tax for LPs, LLPs, and LLCs not classified as corporations, that were small businesses or microbusinesses, as defined, from \$800 to \$400 or \$200, respectively. In addition, under the CTL, this bill would have reduced the minimum franchise tax for corporations that were small businesses or microbusinesses, as defined, from \$800 to \$400 or \$200, respectively. AB 91 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 632 (Ramos, 2021/2022), under the CTL, would have reduced the \$800 minimum franchise tax for corporations, and, by reference, the annual tax for LPs, LLPs, or LLCs not classified as corporations, based on gross receipts. AB 632 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 664 (Bigelow, 2021/2022), under the PITL, would have suspended the due date for payment of the annual tax for LPs, LLPs, and LLCs not classified as corporations, that are small businesses, until the end of the state of emergency declared by the Governor on March 4, 2020. AB 664 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 806 (Chen, et al., 2021/2022), under the PITL, would have exempted LPs, LLPs, and LLCs not classified as corporations from the payment of the annual tax for taxable years beginning on or after January 1, 2020, and before January 1, 2023. In addition, this bill would, under the CTL, have exempted corporations from the payment of minimum franchise tax for taxable years beginning on or after January 1, 2020, and before January 1, 2023. AB 806 did not pass out of the Assembly Revenue and Taxation Committee by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

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FISCAL IMPACT

This bill would impact the department’s systems, resulting in programming and processing revisions, and form revisions as well as the need for taxpayer outreach, however 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 determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 778 as Introduced February 13, 2023
Assumed Enactment after June 30, 2023

(\$ in Millions)

Fiscal Year	Revenue
2023-2024	-\$550
2024-2025	-\$410
2025-2026	-\$370

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.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

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ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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