

ANALYSIS OF AMENDED BILL

Author:	<u>Mayes & Lackey</u>	Analyst:	<u>Jessica Deitchman</u>	Bill Number:	<u>AB 2807</u>
	<u>See Legislative</u>			Introduced Date:	<u>February 19, 2016</u>
Related Bills:	<u>History</u>	Telephone:	<u>845-6310</u>	Amended Date:	<u>March 28, 2016</u>
		Attorney:	<u>Bruce Langston</u>	Sponsor:	<u></u>

SUBJECT: Reduce Minimum Franchise Tax/Extend Exemption for Deployed Military Owned Businesses

SUMMARY

This bill would, under the Corporation Tax Law, reduce the minimum franchise tax for corporations and extend the exemption for corporations solely owned by deployed military members.

RECOMMENDATION

No position.

Summary of Amendments

The bill, as introduced on February 19, 2016, would modify the minimum franchise tax for certain entities and would extend the sunset date for the minimum tax exemption for certain small businesses.

The March 28, 2016, amendments added a coauthor, and further modified provisions relating to the minimum franchise tax as discussed below.

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

REASON FOR THE BILL

The reason for this bill is to provide tax relief for corporations forming in California, by reducing the minimum franchise tax.

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, 2017.

FEDERAL/STATE LAW

Federal law lacks 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).

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 does not apply to any corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax. It also does not apply to limited partnerships; limited liability companies not classified as corporations, limited liability partnerships, charitable organizations, regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, financial asset securitization investment trusts, and qualified Subchapter S subsidiaries.

For taxable years beginning before January 1, 2018, a corporation wholly owned by an individual that is a member of the U.S. Armed Forces is exempt from paying the minimum franchise tax for any taxable year if both of the following apply:

- The owner is deployed during that taxable year, and
- The corporation operates at a loss or ceases operation in that taxable year.

THIS BILL

For taxable years beginning on or after January 1, 2017, this bill would reduce the minimum franchise tax to \$150 for corporations.

Additionally, this bill would extend the exemption from the minimum franchise tax for deployed military owned small business corporations through tax years beginning before January 1, 2020.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems.

TECHNICAL CONSIDERATIONS

To provide additional clarity, the following amendments are recommended:

On page 3, line 1 after "(2)" insert "or subdivision (j)"

On page 6, line 12, strike "notwithstanding subdivision (a), for"

On page 6, line 12 before "taxable" insert "For"

LEGISLATIVE HISTORY

AB 2625 (Lopez, 2015/2016) would reduce the minimum franchise or annual tax for certain new microbusiness for its first five taxable years. AB 2625 is currently before the Assembly Revenue and Taxation Committee.

AB 328 (Grove, 2015/2016) would have exempted new veteran owned small corporations and LLCs from the minimum franchise or annual tax. AB 328 failed to pass out of the assembly by the constitutional deadline.

AB 1769 (Dababneh, 2013/2014) would have exempted certain small business LLCs from the minimum franchise tax for up to two taxable years. AB 1769 failed passage out of the Assembly by the constitutional deadline.

AB 1889 (Hagman, 2013/2014) would have exempted certain small business entities from the minimum franchise tax for up to the first two taxable years. AB 1889 failed passage out of the Assembly by the constitutional deadline.

AB 2428 (Patterson, 2013/2014) would have eliminated the minimum franchise tax for new business entities for up to five taxable years. AB 2428 failed passage out of the Assembly by the constitutional deadline.

AB 2466 (Nestande, et al., 2013/2014) would have reduced or eliminated the annual fee or minimum franchise tax for certain veteran-owned small business LLCs and corporations. AB 2466 failed passage out of the Assembly by the constitutional deadline.

AB 2495 (Melendez, 2013/2014) would have eliminated the minimum franchise tax for new business entities for up to five taxable years. AB 2495 failed passage out of the Assembly by the constitutional deadline.

SB 641 (Anderson, 2013/2014) would have eliminated the minimum franchise tax for certain new corporations for the first four taxable years. SB 641 failed passage out of the Senate by the constitutional deadline.

AB 166 (Cook, 2011/2012) would have eliminated the minimum franchise tax. AB 166 failed passage out of the Assembly by the constitutional deadline.

AB 368 (Morrell, 2011/2012) would have reduced the minimum franchise tax to \$400 for qualified small businesses. AB 368 failed passage out of the Assembly by the constitutional deadline.

AB 821 (Garrick, 2011/2012) would have reduced the minimum franchise tax from \$800 to \$100 for a small business for the first ten years of operation. AB 821 failed passage out of the Assembly by the constitutional deadline.

AB1605 (Garrick, 2011/2012) would have exempted specified entities from the minimum franchise tax or annual tax and reduced the minimum franchise tax or annual tax to \$99 for specified entities that commence business on or after January 1, 2013. AB 1605 failed passage out of the Assembly by the constitutional deadline.

AB 2671 (Cook, Chapter 394, Statutes of 2010) created the exemption from the minimum franchise tax to small businesses solely owned by deployed members of the Armed Forces whose business operates at a loss or ceases to exist.

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, Michigan, and Minnesota do not impose a minimum tax on business entities.

Illinois imposes a \$25 minimum tax on corporations.

Massachusetts imposes a \$456 minimum tax on corporations.

New York imposes a minimum tax on corporations of \$25 to \$5,000 based on the corporation's in-state receipts.

FISCAL IMPACT

Department costs have yet to be determined. As the bill continues to move through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2807 As Amended March 28, 2016 Assumed Enactment After June 30, 2016 (\$ in Millions)		
2016-17	2017-18	2018-19
- \$180	- \$490	- \$500
The revenue associated with deployed armed forces is not included in this estimate.		

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Based on department data, it was determined that in taxable year 2013 approximately 540,000 corporations would have saved an estimated \$350 million if the minimum franchise tax was decreased from \$800 to \$150. The tax year estimate is then adjusted to reflect changes in the economy over time, resulting in an estimated \$460 million revenue loss in 2017. The tax year estimates were converted to fiscal years and rounded to arrive at the figures in the above table.

Current law allows a minimum franchise tax exemption to small businesses solely owned by deployed members of the Armed Forces whose business operates at a loss or ceases to exist. Because the department is unable to predict future deployment and business operations, the revenue impact of extending the sunset date is unknown. It is expected that for every 100 small businesses that would have paid the minimum franchise tax there would be a revenue loss of \$65,000.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the bill would give a needed tax break to corporations in California and therefore assist them to stay in business.

Opponents: Some may argue that providing a tax break to corporations only may be overly narrow and inadvertently exclude other business owners that need assistance.

POLICY CONCERNS

This bill would provide a tax benefit for corporations that would not be provided to other business types. Thus, this bill would provide differing treatment based solely on classification.

LEGISLATIVE STAFF CONTACT

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