Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Gatto	Analyst:	Diane Deatherage	Bill Number:	AB 2490
Related Bills:	None	Telephone:	845-4783	Amended Dates:	April 11, 2016 & April 26, 2016
		Attorney:	Bruce Langston	Sponsor	

SUBJECT: Exempt Corporations/Adds Regulated Mutual Fund Investment Companies

SUMMARY

Under Corporate Tax Law, this bill would exempt certain regulated investment companies (RICs) from tax.

RECOMMENDATION

No position.

Summary of Amendments

The April 11, 2016, amendments removed provisions of the bill related to federal tax law reporting, and added provisions relating to certain RICs. The April 26, 2016, amendments added substantive provisions relating to RICs.

The department's analysis of the bill as amended March 17, 2016, no longer applies.

REASON FOR THE BILL

The reason for the bill is to explicitly exempt from state taxes any mutual fund investment management company owned by the mutual funds that it serves.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2016.

FEDERAL LAW

Under Section 851 of the Internal Revenue Code, a RIC is an entity that meets certain requirements (including a requirement that its income generally be derived from passive investments such as dividends and interest and a requirement that it distribute at least 90 percent of its income) and that elects to be taxed under a special tax regime. Unlike an ordinary corporation, an entity that is taxed as a RIC can deduct amounts paid to its shareholders as dividends. In this manner, tax on RIC income is generally not paid by the RIC but rather by its shareholders. Income of a RIC distributed to shareholders as dividends is generally treated as an ordinary income dividend by those shareholders, unless other special rules apply.

STATE LAW

Prior to being repealed in 1988, RICs were entitled to tax exemption.

Under current tax law, California generally conforms to the federal treatment of RICs.

A tax-exempt organization that regularly carries on a trade or business not substantially related to its exempt purpose is required to pay tax on the unrelated trade or business income[1] that results from such activity.

THIS BILL

This bill would exempt from corporate income and franchise taxes, except unrelated business income tax, a RIC that is a mutual fund investment management company owned by the investors of the mutual funds that it serves.

This bill provides that the Franchise Tax Board (FTB) may promulgate regulations as necessary or appropriate to carry out the purposes of this exemption.

IMPLEMENTATION CONSIDERATIONS

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

This bill uses a phrase that is undefined, i.e., "mutual fund investment management company." The absence of a definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

The bill is silent on information return filing requirements and therefore a RIC that qualifies for tax exemption would have no filing requirement, which would be difficult for the department to administer compliance and enforcement. If this is not the author's intent, the bill should be amended.

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.

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[1] Revenue and Taxation Code Article 2 (commencing with Section 23731).

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a tax exemption comparable to the tax exemption allowed by this bill. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

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 and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Because this bill would impact less than three taxpayers, providing a revenue estimate would violate the FTB's taxpayer confidentiality rules, therefore, no revenue estimate is provided.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that this bill may stimulate investments by allowing a tax exemption, and therefore lower investor fees, for investment management companies with a specific corporate structure.

Opponents: Some may argue that this change to current law would provide a tax benefit for investment management companies with a specific corporate structure and other investment management companies would be ineligible.

POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

This bill would provide a tax benefit for mutual fund investment management companies that have a specific structure that would not be provided to other investment management companies.

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