Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Lopez	Analyst:	Jessica Deitchman	Bill Number:	AB 2625
Related Bills:	See Legislative History	Telephone:	845-6310	Introduced Date: Amended Date:	February 19, 2016 April 6, 2016
		Attorney:	Bruce Langston	Sponsor	

SUBJECT: Annual Tax & Minimum Franchise Tax/Reduce First 5 Taxable Years for New Microbusiness

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), reduce the annual or minimum franchise tax imposed on certain new microbusiness entities.

RECOMMENDATION

No position.

Summary of Amendments

The bill, as introduced on February 19, 2016, would have reduced the minimum franchise or annual tax for certain microbusiness entities.

The April 6, 2016, amendments modified the operative date, several definitions and eligibility for the reduced annual or minimum franchise tax as discussed in this analysis.

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 new small businesses by reducing the minimum franchise tax or annual 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.

STATE LAW

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 $800 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 x 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.

Under existing state law, the annual tax on limited partnerships, limited liability companies not classified as corporations, and limited liability partnerships is set at $800 by reference to the minimum franchise tax.

THIS BILL

For taxable years beginning on or after January 1, 2017, this bill would, under the PITL and CTL, reduce the amount of minimum franchise or annual tax imposed on a new microbusiness that is a limited partnership (LP), limited liability company (LLC) and limited liability partnership (LLP) for each of the first five years and for a corporation for its second, third, fourth, and fifth taxable years to the amounts shown in the table below:

Gross receipts of $50,000 or less	Gross receipts of $100,000 or less but more than $50,000	Gross receipts of $150,000 or less but more than $100,000	Gross receipts of more than $150,000
$200	$400	$600	$800

For any taxable year in which an LLC has qualified to pay a reduced annual tax, but has gross receipts, less returns and allowances, derived from or attributable to this state which exceed the amount specified for that reduced amount, an additional tax in an amount equal to $600, $400 or $200, as applicable, for that taxable year would be due and payable by the LLC on the due date of the return without regard to extension for that taxable year.

The bill would define the following terms:

- "Gross receipts, less returns and allowances" means the sum of the gross receipts from the production of business income and the gross receipts from the production of nonbusiness income.
    - Gross receipts, less returns and allowances, derived from or attributable to this state" would be determined using the rules for assigning sales under current law and the regulations thereunder, as modified by regulations under Section 25137, other than those provisions that exclude receipts from the sales factor.

For corporations:

- "New microbusiness" means an LLC that on or after January 1, 2017, is organized under the laws of this state or has qualified to transact intrastate business in this state and has first commenced doing business in this state on or after the time of its organization. In determining whether the taxpayer has first commenced doing business in the state during the taxable year, the provisions of subdivision (f) of Section 17276 would apply except that "new microbusiness" would be substituted for "new business."

For LLC, LLP, and LPs:

- "New microbusiness" means an LLC, LLP, or LP that on or after January 1, 2017, is organized under the laws of this state or has qualified to transact intrastate business in this state and has first commenced doing business in this state on or after the time of its organization. In determining whether the taxpayer has first commenced doing business in the state during the taxable year, the provisions of subdivision (f) of Section 17276 shall apply except that "new microbusiness" shall be substituted for "new business."

Gross receipts derived from or attributable to this state of any other business, in whatever form conducted, that is owned directly or indirectly by persons that are treated as related to the new microbusiness, would be aggregated with the gross receipts derived from or attributable to the state of the new microbusiness to determine whether the new microbusiness qualifies for the reduced annual tax under this bill.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

To clarify existing law the following amendments are recommended.

On page 7, line 7, strike "or (b)" and insert ",(b), or (f)"

On page 16, line 38, after "(a)" insert "or (f)"

On page 16, between lines 11 and 12." Insert:

(II) "For any taxable year beginning on or after January 1, 2017, if a corporation has qualified to pay a reduced minimum franchise tax under this subdivision for any taxable year, but in that taxable year, the corporation's gross receipts, less returns and allowances, derived from or attributable to this state, exceed the amount specified for that reduced amount, an additional tax in an amount equal to six hundred dollars ($600), four hundred dollars ($400), or two hundred dollars ($200), as applicable, for that taxable year shall be due and payable by the corporation on the due date of its return, without regard to extension, for that taxable year.

To correct a cross referencing errors, the following amendments are recommended:

On page 15, line 39, strike (f) and insert, (g)

On page 15, line 39, strike “17276” and insert “24416”

On page 16, line 11, after “reduced” strike “annual” and insert “minimum franchise tax”

On page 16, line 3, strike “subdivision” and insert “subparagraph”

LEGISLATIVE HISTORY

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.

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, *Massachusetts*, and *New York* do impose a minimum tax on corporations, but they lack an exemption similar to the one proposed in this bill.

FISCAL IMPACT

Department costs have yet to be determined. As the bill continues to move through the legislative process, costs will be identified and a budget change proposal may be pursued if necessary.

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2625 As Amended April 6, 2016 Assumed Enactment After June 30, 2016 ($ in Millions)		
2016-17	2017-18	2018-19
-$13	-$55	-$110

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 new business registration data from the Secretary of State (SOS) and data from the department for years 2009-2015, it is estimated that in 2017 approximately 88,000 corporations, and 45,000 new LLCs, LLPs, and LPs would register and be doing business per the limitations specified in the bill.

The estimated revenue loss for 2017 does not include corporations because they are not subject to minimum franchise tax in their first year of operation. However, approximately 45,000 LLCs, LPs, and LLPs would be subject to the annual tax and benefit from the reduced tax in tax year 2017, resulting in an estimated revenue loss of $22 million. For the 2018 tax year, it is estimated that 80,000 first and second year LLCs, LPs, and LLPs and 70,000 second year corporations would benefit from reduced minimum franchise and annual tax for a total estimated revenue loss of $90 million. The revenue loss would be phased in over a five year period, reaching $230 million in 2021 and would continue to increase with the establishment of new microbusinesses in California.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the estimates shown in the above table.

SUPPORT/OPPOSITION[1]

Support: Cal Small Business.

Opposition: None provided.

ARGUMENTS

Proponents: Some may argue that the tax relief provided by this bill would reduce the financial pressure on new microbusinesses that could lead to business failure.

Opponents: Some may argue that providing tax relief to new microbusinesses may be overly narrow and inadvertently exclude other business owners that need assistance.

LEGISLATIVE STAFF CONTACT

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[1] As listed in the staffer provided fact sheet.