



Bill Analysis

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Bill Number: AB 308

Subject: Exemption from Annual Tax and Minimum Franchise Tax for Small Business Limited Liability Companies and Corporations Owned by a Deployed Member of the U.S. Armed Forces

Summary

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow an exemption from the annual tax or the minimum franchise tax for certain small business Limited Liability Companies (LLCs), and corporations that are solely owned by a deployed member of the United States (U.S.) Armed Forces, and if double-joining language becomes operative, modify the minimum franchise tax for corporations having less than \$15 million in gross receipts.

Reason for the Bill

The reason for this bill is to provide tax relief for certain small businesses in California.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment.

The provision exempting certain small business LLCs and corporations from the annual tax or minimum tax would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2030.

The modified minimum franchise tax provision would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025, if both this bill and SB 349:

- 1) Are enacted and become effective on or before January 1, 2020,
- 2) Amend Revenue and Taxation Code (R&TC) section 17941, and
- 3) This bill is enacted after SB 349.

Federal/State Law

Federal law lacks an annual minimum tax for LLCs and a minimum franchise tax for corporations.

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).

State law currently requires LLCs not classified as corporations that are organized, registered, or doing business in the state to pay an annual tax, in an amount equal to the minimum franchise tax, which is currently \$800. In addition to the annual tax, an annual fee based on the total income from all sources derived from or attributable to the state may apply.

This Bill

This bill would, under the PITL and CTL, replace the existing January 1, 2018, inoperative date with January 1, 2030, and re-establish for taxable years beginning on or after January 1, 2020, and before January 1, 2030, an exemption from the annual tax or minimum franchise tax as applicable, for LLCs and corporations that are small businesses that meet all of the following:

- Is solely owned by a deployed member of the U.S. Armed Forces,
- Is a small business, and
- Operates at a loss or ceases operation for the taxable year.

The following definitions would apply for purposes of the exemption:

- “Deployed” means being called to active duty or active service during a period when a Presidential Executive order specifies that the United States is engaged in combat or homeland defense. Deployed would specifically exclude temporary duty for the sole purpose of training or processing, or a permanent change of station.
- “Operates at a loss” means:
 - Expenses exceed receipts with respect to an LLC.
 - Negative net income as defined in R&TC section 24341 with respect to a corporation.
- “Small business” means an LLC or a corporation with total income from all sources derived from or attributable to California of \$250,000 or less.

The Franchise Tax Board (FTB) would be allowed to promulgate regulations as necessary or appropriate, including defining “ceases operation.”

The FTB would be required, on or before January 1, 2021, and on or before January 1 annually thereafter through January 1, 2031, to submit a report to the Legislature on the performance of LLCs and corporations that are small businesses solely owned by a deployed member of the U.S. Armed Forces, that would include:

- The number of small business LLCs and corporations that are solely owned by a deployed member of the U.S. Armed Forces in the state,
- The number of individuals employed by these businesses, and
- The number of these businesses that close.

This bill also contains double-joining language that would incorporate provisions from SB 349 (Portantino), modifying the minimum franchise tax imposed on corporations, based on gross receipts during the taxable year, as shown below, changing the cross reference in the annual tax provision to retain the \$800 minimum for entities subject to the annual tax, and requiring in uncodified law, the FTB to submit an annual report on the performance of small businesses affected by the bill’s reduction in the minimum franchise tax to the Legislature, as specified.

The minimum franchise tax would be determined as follows:

<u>Gross receipts less than \$2,500,000</u>	<u>Gross receipts of \$2,500,000 or more but less than \$7,500,000</u>	<u>Gross receipts of \$7,500,000 or more but less than \$15,000,000</u>	<u>Gross receipts of \$15,000,000 or more</u>
\$200	\$400	\$600	\$800

Legislative History

SB 349 (Portantino 2019/2020), would modify the minimum franchise tax imposed on corporations, based on gross receipts during the taxable year. SB 349 was enrolled on September 13, 2019.

AB 364 (Calderon, 2019/2020) would reduce the annual tax for the first year for new, small business LPs or LLCs. AB 364 failed to pass out of the Assembly Committee on Revenue and Taxation.

AB 1256 (Brough, 2017/2018) would have reduced the minimum franchise tax or annual tax for the first or second year for new, small businesses corporations, LLCs Limited Liability Partnership (LLPs), and Limited Partnerships (LPs). AB 1256 failed passage out the Assembly by the constitutional deadline.

AB 2510 (Muratsuchi, 2017/2018) would have allowed an LLC that is a microbusiness to pay a reduced annual tax of \$100, and reinstated the exemption from the annual tax for certain deployed military-owned small business LLCs. AB 2510 failed passage out of the Assembly by the constitutional deadline.

SB 248 (Morrell, 2017/2018) would have eliminated and reduced the minimum franchise tax or annual tax for the first six taxable years for new, small business corporations, LLCs, LLP, and LP). SB 248 failed passage out of the Senate by the constitutional deadline.

AB 328 (Grove, 2015/2016) would have eliminated the minimum franchise tax or annual tax for new veteran-owned small corporations and LLCs. AB 328 failed passage out of the Assembly by the constitutional deadline.

AB 612 (Patterson, 2015/2016) would have reduced the annual tax to \$400 for the first year for new, small business LPs, LLCs, and LLPs, and reduced the minimum franchise tax to \$400 for the second year for new, small business corporations. AB 612 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, Illinois, Michigan, and Minnesota do not impose a minimum tax on corporations or partnerships.

Massachusetts imposes a \$456 minimum excise tax on corporations, including small business corporations, and imposes no minimum tax on partnerships.

New York imposes a minimum income tax of \$25 on most corporations, and a minimum annual filing fee of \$25 on certain partnerships.

Fiscal Impact

Should the double-joining language become operative, staff estimates a cost of approximately \$385,000 in fiscal year 2019-2020 and ongoing costs of \$374,000 in fiscal year 2020-2021, \$7,000 in fiscal year 2021-2022, and \$4,000 in fiscal years 2022-2023 and 2023-2024 to develop, program, and test revisions to existing systems necessary to implement the reporting related to the reduced minimum franchise tax provision of this bill. The department will pursue a budget change proposal if necessary.

If the double-joining language fails to become operative, implementing this bill would not significantly impact the department's costs.

Economic Impact

This bill would result in the following revenue loss:

Estimated Revenue Impact of SB 308
 Assumed Enactment by September 30, 2019

(\$ in Millions)

Fiscal Year	Revenue*
2019-2020	-\$120
2020-2021	-\$320
2021-2022	-\$340

*These values include the revenue impact if the double-joining language that would incorporate provisions from SB 349 (Portantino) modifying the minimum franchise tax imposed on corporations, based on gross receipts during the taxable year, becomes operative.

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.

Revenue Discussion

This bill would specify that the amount of minimum franchise tax would be determined in accordance with the taxpayer's "gross receipts." Based on data from the FTB for tax years 2013 through 2016, it is estimated that in taxable year 2020 approximately 580,000 corporations would be impacted by the changes to the amount of the minimum franchise tax as proposed in this bill.

The estimated revenue loss from the proposed changes to the minimum franchise tax for C and S corporations would be approximately \$315 million in the 2020 taxable year. This consists of minimum franchise tax that would no longer be paid, offset by measured tax. C and S corporate taxpayers must pay the measured tax only if it is more than the minimum franchise tax.

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

Previous law allowed a minimum franchise tax and an annual tax exemption to small businesses solely owned by deployed members of the U.S. Armed Forces, whose business operates at a loss or ceases to exist. Because the FTB is unable to predict future deployment and business operations, the revenue impact of reinstating the exemptions is unknown. It is expected that for every 100 small businesses that would have paid the annual tax there would be a revenue loss of \$80,000.

Appointments

None.

Votes

Location	Date	Yes Votes	No Votes
Concurrence	September 11, 2019	78	0
Senate Floor	September 10, 2019	40	0
Assembly Floor	May 22, 2019	77	0

Legislative Staff Contact

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