DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: March 19, 2007
POSITION: Neutral

BILL NUMBER: SB 105
AUTHOR: C. Migden
RELATED BILLS: Ch. 802/2006 (SB 1827), Ch. 421/2003 (AB 205)

BILL SUMMARY: Taxation: Registered Domestic Partners: Filing Status

This bill would clarify the definition of registered domestic partners as spouses for income tax purposes, as specified.

FISCAL SUMMARY

This bill would not impact the state's income tax revenue.

This bill would not significantly impact Franchise Tax Board (FTB) costs.

COMMENTS

The FTB states that the amendment providing that registered domestic partners (RDPs) would be treated as spouses or former spouses is declaratory of existing law and would have no impact on state income tax revenue.

This bill would provide an exception to treating RDPs as spouses for business entity classifications (e.g., S corporations) to avoid having an entity classified differently for state purposes than for federal purposes.

Analyst/Principal (0723) C. Angaretis	Date	Program Budget Manager Mark Hill	Date
Department Deputy Director			Date
Governor's Office:	By:	Date:	Position Approved_______ Position Disapproved

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ANALYSIS

A. Programmatic Analysis

Current federal law treats registered domestic partners (RDPs) as single individuals instead of spouses that are married or members of the same family.

An S corporation is a form of a corporation that enables the company to enjoy the benefits of incorporation but is taxed similar to a pass-through entity (i.e. partnership). A corporation may elect to be treated as an S corporation if certain requirements are met. One of those requirements is that the S corporation's total shareholders must be less than or equal to 100. Spouses and all members of a family are treated as one shareholder.

Current state law requires RDPs to file a personal income tax return jointly or separately by applying the standards applicable to married couples under federal income tax law. RDPs are treated as spouses for state income tax purposes.

A corporation may qualify as an S corporation under California law only if it has a valid federal S corporation election in effect. In other words, the federal S corporation requirements must also be met for California purposes. There is no independent California election allowed that would permit a federal S corporation to elect to be taxed as a regular corporation for California purposes. Similarly, current law does not allow a corporation to be an S corporation only for California purposes.

In meeting the less than or equal to 100 shareholder S corporation requirement, RDPs will be treated as one shareholder for state purposes versus two shareholders for federal purposes. This could result in a corporation that was not eligible to be an S corporation for federal purposes to be an S corporation for California purposes. Similar issues arise in connection with the classification of business entities based on whether the entity is owned by one person or by more than one person.

This bill would clarify that an RDP or former RDP would be treated as a spouse or former spouse for personal income tax and corporation tax purposes.

This bill would provide an exception to treating RDPs as spouses for business entity classifications to avoid having an entity classified differently for state purposes than for federal purposes. For example, this exception would avoid an S corporation meeting the 100 shareholder requirement for state purposes and not for federal purposes because there were two RDP shareholders that for federal purposes put the total amount to 101 shareholders, disqualifying the S corporation status.

This bill would be effective immediately as a tax levy and specifies that it would apply to taxable years beginning on or after January 1, 2007.

Discussion:

The FTB surveyed several states (including Illinois, Massachusetts, Michigan, Minnesota, and New York) with tax laws similar to that of California's income tax laws. Only Massachusetts allows domestic partners to file tax returns as married filing joint or married filing separate.

The FTB found no provisions in Massachusetts law which handles the state and federal difference of treating registered domestic partners as one shareholder or two shareholders.

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B. Fiscal Analysis

This bill would not impact the state's income tax revenue. The FTB also notes that there could be circumstances under which a particular business entity classification type would be allowed under state law but not under federal law (e.g., an S corporation that would exceed the limit on the number of owners if RDPs were counted separately, but not if they are counted jointly). The FTB is unaware of any specific entities that would be classified differently for state purposes because shareholders are RDPs. The FTB revenue estimate assumes that taxpayers generally follow federal law when choosing an entity type and that businesses will not suffer adverse consequences from entity reclassifications under current state law. Therefore, this bill would have no revenue impact.

This bill would not significantly impact FTB costs.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	2006-2007	FC	2007-2008	FC	2008-2009	Fund Code
			(Fiscal Impact by Fiscal Year) (Dollars in Thousands)						
1147/Pers Inc Tax	RV	Yes		------------------- No/Minor Fiscal Impact -------------------					0001
1730/FTB	SO	No		------------------- No/Minor Fiscal Impact -------------------					0001