Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author: Kehoe | Analyst: Darrine Distefano | Bill Number: AB 1510

Related Bills: See Legislative History | Telephone: 845-6458 | Amended Date: August 23, 2004

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/ Middle River Levee Break In San Joaquin County/Los Angeles, San Bernardino, Riverside, San Diego, & Ventura County Fires/Santa Barbara & San Luis Obispo County San Simeon Earthquake

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the following recent disasters:

- Middle River levee break in San Joaquin County,
- Southern California wildfires,
- Floods, mudflows, and debris flows directly related to the Southern California wildfires, and
- San Simeon earthquake.

This bill also would provide funding to local agencies for financial assistance to repair or rebuild improvements to public property related to government services and damaged by the 2003 disasters. This analysis will not address these changes, as they do not impact the department.

SUMMARY OF AMENDMENTS

The August 23, 2004, amendment adds several co-authors. The August 17, 2004, amendments added the provisions pertaining to disaster loss tax treatment. The May 4, 2004, amendments included provisions related to appropriating funds to local governments to make up for property tax losses arising from the 2003 disasters.

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

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to provide immediate tax relief to individuals and businesses affected by the levee break, the Southern California wildfires, and earthquake.

EFFECTIVE/OPERATIVE DATE

This bill is an urgency measure. It would be effective and operative immediately upon enactment.

POSITION

No position.

Board Position:			Department Director	Date
______ S	______ NA	__X__ NP		
______ SA	______ O	______ NAR		
______ N	______ OUA	______ PENDING	Will Bush	8/30/04

ANALYSIS

FEDERAL/STATE LAW

Under federal and state law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Under federal and state tax law, the taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made prior to passage of any state legislation allowing special carryover treatment because California conforms to the federal election.

Nonbusiness disaster losses not reimbursed by insurance or otherwise are deductible under state and federal tax law to the extent each loss exceeds $100. Total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income.

State tax law identifies specific events as disasters that are then allowed additional special carry forward treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, the remaining excess loss may be carried over at a specified percentage for up to 10 additional years.

THIS BILL

This bill would add the following disasters to the current list of specified disasters under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL):

- The Middle River levee break in San Joaquin County,
- The wildfires that occurred in October and November of 2003 in the Counties of Los Angeles, San Bernardino, Riverside, San Diego, and Ventura, and the floods, mudflows, and debris flows directly related to those fires, and
- The San Simeon earthquake and related casualties that occurred in December 2003.

Specifically, this bill would allow special disaster treatment of losses sustained as a result of those disasters. The $100 and 10% of adjusted gross income limitations in existing law would apply to disaster losses on nonbusiness property.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

For consistency, the author may wish to revise the order of the disasters, listing the Middle River levee break last since it was the most recent disaster. Most disasters are listed as it occurs in date order, with the most recent listed last to avoid confusion for taxpayers.

On page 8, line 11, and page 11, line 11; insert the word "those" between "to" and "fires."

On page 8, line 14, and page 11, line 14; after the word "casualties," insert the term "occurring in December 2003."

LEGISLATIVE HISTORY

AB 2165 (Houston, 2003/2004) would allow taxpayers disaster loss tax treatment for losses sustained as a result of the Middle River levee break in San Joaquin County. AB 2165 is currently on the Assembly Floor.

SB 438 (Soto & Hollingsworth, 2003/2004) would have allowed taxpayers disaster loss tax treatment for losses sustained as a result of the Southern California wildfires, losses related to the wildfires, and the San Simeon earthquake. Governor Schwarzenegger vetoed this bill. The veto message stated the basis for returning the bill was the "the State's current fiscal constraints."

AB 44 (Wiggins, Stat. 2001, Ch. 618) allowed taxpayers disaster loss tax treatment for losses sustained as a result of the earthquake that occurred September 2000 in Napa, California.

PROGRAM BACKGROUND

The President and the Governor have proclaimed the Middle River levee break, the Southern California wildfires, and losses related to the wildfires a disaster. The San Simeon earthquake was proclaimed to be a disaster by Governor Schwarzenegger.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Estimated PITL Revenue Impact Middle River Levee, Southern CA Wildfires, and San Simeon Earthquake As Amended August 23, 2004 (In Millions) **Fiscal Year Impact**			
2003-2004	**2004-05**	**2005-06**	**2006-07**
Minor loss	-$5	-$9	-$4

Minor = Less than $500,000

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

Revenue Discussion

In order for a taxpayer to calculate the amount of disaster loss that can be deducted, the taxpayer uses three factors. First, the loss must be limited to the basis of the property (cost of the property plus cost of any improvements minus deductions such as depreciation). Second, any insurance proceeds or reimbursements must be deducted. Third, the taxpayer subtracts 10% of their federal adjusted gross income (AGI). The remaining amount is the disaster loss that can be claimed by the taxpayer.

Middle River Levee

The impact of this proposal will depend on the amount of disaster losses carried back, instead of carried forward at 100% under current law.

It is estimated that the total cost of fighting the flooding caused by the Middle River levee break will be nearly $53 million. The total amount of damages was estimated to be $10 million. Since the majority of the damages were crop losses, it is assumed that none of these losses would be reimbursed by insurance coverage and that approximately 90% would be business related losses. This yields approximately $1 million in personal property loss.

Using the department's disaster loss model, after reducing qualifying losses for AGI and basis limitations of $250,000 and estimated first year usage of $225,000 (historical usage of similar losses under current law), it is projected that $525,000 in additional losses will be allowed to be carried forward or back under this bill ($1 million - $250,000 - $225,000 = $525,000). At a 6% average marginal tax rate, the total revenue loss over the 2003-2007 fiscal years is estimated to be approximately $32,000 ($525,000 x 6% ~ $31,500).

Southern CA Wildfires and San Simeon Earthquake

The impact of this bill would depend on the amount of disaster losses carried back, carried forward at 100% instead of 60%, and the amount of carryover losses deducted in subsequent years.

The estimated losses were determined in several steps. First, it is assumed that the special disaster loss treatment provided in this bill would be for losses sustained as a result of the Southern California wildfires, floods, mudflows, debris flows directly related to the fires, and the San Simeon earthquake. Second, the total amount of damages for the Southern California wildfires was estimated to be $2.8 billion and the total amount of damages from the San Simeon earthquake was estimated to be $34 million, all in private losses.

It is estimated that approximately 20% of fire damage and 90% of the earthquake damage would not be reimbursed by insurance coverage for a total deductible loss of $590 million ($2.8 billion x 20% + $34 million x 90% = $590 million).

Using the department's disaster loss model, after applying qualifying losses for AGI and basis limitations of $147 million and an estimated first year usage of $148 million (historical use of similar losses under current law), it is projected that $250 million in losses would be allowed to be carried forward under the bill ($590 million - $147 million - $148 million = $295 million).

At a 6% average marginal tax rate, the total revenue loss over a period of a few fiscal years is estimated to be approximately $18 million, all attributable under the PITL ($295 million x 6% ~ $18 million).

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