Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Houston	Analyst:	Darrine Distefano	Bill Number:	AB 2165
Related Bills:	See Legislative History	Telephone:	845-6458	Amended Date:	June 21, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Middle River Levee Break In San Joaquin County

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the Middle River levee break in San Joaquin County.

This bill would also make changes related to financial assistance to local agencies and water rights fees. This analysis will not address these changes, as they do not impact the department or state income tax revenue.

SUMMARY OF AMENDMENTS

The June 21, 2004, amendments deleted the provisions relating to real estate brokers and inserted the provisions discussed in this analysis.

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.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

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.

Board Position:			Department Director	Date
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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 Middle River levee break in San Joaquin County to the current list of specified disasters under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL).

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

This bill does not include the Southern California wildfires, losses related to the wildfires, and the San Simeon earthquake. Currently there are two disaster bills, SB 438 and SB 1147 in the Legislature that include these disasters. If AB 2165, as amended June 21, 2004, were to be enacted after either SB 438 or SB 1147, AB 2165 would chapter out the provisions relating to those disasters. Department staff is working with the author's office to develop amendments to include these disasters.

LEGISLATIVE HISTORY

SB 438 (Soto & Hollingsworth, 2003/2004) and SB 1147 (Hollingsworth & Soto, 2003/2004) would add the Southern California wildfires, losses related to the wildfires, and the San Simeon earthquake to the current list of specified disasters. However, SB 1147 does not contain net operating losses (NOL) clarifying language or the floods, mudflows, and debris flows directly related to the Southern California wildfires. SB 438 is currently enrolled. SB 1147 is currently in the Assembly Revenue & Taxation Committee.

AB 44 (Wiggins, Stat. 2001, Ch. 618) covered losses for the earthquake that occurred September 2000 in Napa, California.

FISCAL IMPACT

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

ECONOMIC IMPACT

Revenue Estimate

Estimated PITL & CTL Revenue Impact AB 2165 – Middle River Levee As amended June 21, 2004 (In Millions) **Fiscal Year Impact**				
Fiscal Year	**2003-04**	**2004-05**	**2005-06**	**2006-07**
Revenue Loss - PITL	Negligible	Insignificant	Insignificant	Insignificant
Revenue Loss - CTL	Negligible	Insignificant	Insignificant	Insignificant

Negligible = Less than $250,000
Insignificant = Less than $150,000

Estimated PIT Revenue Impact AB 2165 – Middle River Levee, Southern CA Wildfires, and San Simeon Earthquake As Proposed To Be Amended (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

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 for Middle River levee break was estimated to be $10 million in crop losses. 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 all would be business related losses. It is assumed that half of these businesses file returns under PITL and another half file returns under the CTL ($10 million/2 = $5 million for each). The revenue impact for PITL is estimated to be a $75,000 revenue loss ($5 million loss x 25% of taxpayers that would have income in the 2003 tax year to offset x 6% average marginal tax rate). The revenue impact for CTL is estimated to be an $110,000 revenue loss ($5 million loss x 25% of taxpayers that would have income in 2003 tax year to offset x 8.84% tax rate).

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).

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. 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).

LEGISLATIVE STAFF CONTACT

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