

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Hollingsworth & Soto, et. Al Analyst: Darrine Distefano Bill Number: SB 1147

Related Bills: See Prior Analysis Telephone: 845-6458 Amended Date: April 21, 2004

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Los Angeles, San Bernardino, Riverside, San Diego, & Ventura County Fires

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced January 26, 2004.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO Support.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED January 26, 2004 STILL APPLIES.

OTHER - See comments below.

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the Southern California wildfires, losses related to the wildfires, and the San Simeon earthquake and related casualties.

This analysis will not address the provisions related to property tax, as they do not impact the department.

SUMMARY OF AMENDMENTS

The April 21, 2004, amendments:

- Add damage that occurred as a result of the San Simeon earthquake and related casualties to the list of disasters under the Personal Income Tax Law and the Corporation Tax Law, and
- Add a principal author.

The April 21st amendments do not resolve the department's technical considerations from the January 26, 2004 analysis. The technical concerns, revenue estimate, and suggested amendments are provided below for convenience. The April 21st amendments did not affect the original revenue estimate provided in the department's January 26th analysis. The original revenue estimate anticipated the addition of both the casualties related to the wildfires and the San Simeon earthquake. The remainder of the department's analysis of the bill as amended January 26, 2004, still applies.

Board Position:

S _____ NA _____ NP
_____ SA _____ O _____ NAR
_____ N _____ OUA _____ PENDING

Legislative Director

Date

Brian Putler

4/30/04

POSITION

Support.

At its February 25, 2004, meeting the Franchise Tax Board voted 2-0 to support this bill with the representative of the Department of Finance abstaining.

TECHNICAL CONSIDERATIONS

The Governor requested and the President authorized the Federal Emergency Management Agency to expand the disaster declaration to include floods, mudflows, and debris flows that were a direct result of the Southern California wildfires. Amendments 1 and 4 are provided at the author's request to add to the list of specified disasters the expanded damages resulting from the wildfires.

Also, clarifying amendments have been included under the Personal Income Tax Law and Corporation Tax Law. Amendments 2 and 5 clarify the net operating loss percentage applicable for excess disaster loss. The wildfires occurred in 2003 when the applicable percentage for net operating loss (NOL) was 60%. Therefore, if a taxpayer affected by the wildfires has any excess disaster loss remaining after five years, 60% of the remaining loss can be carried over for an additional 10 years.

Amendments 3 and 6 eliminate unnecessary language and clarify that for state income tax purposes federal treatment for disasters applies to a Governor-only declared disaster.

ECONOMIC IMPACT

Based on the discussion below, the revenue losses from this bill are as follows (assumes legislation enacted after June 30, 2004):

Estimated PIT Revenue Impact SB 1147 as amended April 21, 2004 (In Millions) Fiscal Year Impact		
2004-05	2005-06	2006-07
-\$5	-\$9	-\$4

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

Revenue Discussion

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, the expanded wildfire disaster coverage, 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 in private losses.

It is estimated that approximately 20% of fire damages and 90% of the earthquake damage would not be reimbursed by insurance coverage for a total deductible loss of \$590 million ($\$2.8 \text{ billion} \times 20\% + \$34 \text{ million} \times 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 \text{ million} - \$147 \text{ million} - \$148 \text{ 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 \text{ million} \times 6\% \sim \18 million).

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1147
As Amended April 21, 2004

AMENDMENT 1

On page 7, line 8, strikeout "." and insert:

, or as a result of floods, mudflows, and debris flows directly related to the fires.

AMENDMENT 2

On page 7, line 20, after "17276" insert:

operative for the year the disaster loss was sustained

AMENDMENT 3

On page 7, strikeout lines 35-38 and insert:

(d) Section 165(i) of the Internal Revenue Code shall be modified to additionally apply to any of the losses listed in subdivision (a) which was proclaimed by the Governor to be in a state of disaster.

AMENDMENT 4

On page 10, line 8, strikeout "." and insert:

, or as a result of floods, mudflows, and debris flows directly related to the fires.

AMENDMENT 5

On page 10, line 19, after "24416" insert:

operative for the year the disaster loss was sustained

AMENDMENT 6

On page 10, strikeout lines 33-36, and insert:

(d) Section 165(i) of the Internal Revenue Code shall be modified to additionally apply to any of the losses listed in subdivision (a) which was proclaimed by the Governor to be in a state of disaster.