Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Berg	Analyst:	Nicole Kwon	Bill Number:	AB 1798
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	January 9, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Del Norte, Humboldt, Lake, Mendocino, Napa, Sonoma & Trinity County Rainstorms, Related Flooding Slides & Any Other Related Casualties

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the severe rainstorms and related events that occurred in Del Norte, Humboldt, Lake, Mendocino, Napa, Sonoma, and Trinity Counties.

This analysis will not address the bill's changes to the Property Tax Law as those changes do not impact the department or state income tax revenue.

PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to provide immediate tax relief to individuals and businesses affected by the severe rainstorms and related events of December, 2005, and January, 2006, in Del Norte, Humboldt, Lake, Mendocino, Napa, Sonoma, and Trinity Counties.

EFFECTIVE/OPERATIVE DATE

As introduced, this bill is an urgency statute and would be effective and operative immediately.

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.

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 for any Presidentially-declared disaster prior to passage of any state legislation allowing special carryover treatment because California conforms to federal law in this area without the need for additional state enabling legislation. The election is available for a Governor-only declared disaster only if enabling legislation is enacted.

Board Position:			Department Director	Date
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The loss for tax purposes is calculated as the lesser of the reduction in fair market value (FMV) or the adjusted basis. This value is reduced by insurance or other reimbursements. A nonbusiness disaster loss not reimbursed by insurance or otherwise is further deductible under both state and federal tax law to the extent of two limitations: basis limitation and adjusted gross income (AGI) limitation. Under the basis limitation, a nonbusiness disaster loss is deductible to the extent the loss exceeds $100. Under the AGI limitation, total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of AGI.

State tax law identifies specific events as disasters that are then allowed additional special loss carry over treatment. Carryover of a disaster loss occurs when the loss computed exceeds the taxable income. Under special loss carryover treatment, 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 loss may be carried over at a specified percentage for up to 10 additional years.

BACKGROUND

Governor Schwarzenegger proclaimed a disaster due to the severe rainstorms and related events in Del Norte, Humboldt, Mendocino, Napa, Sonoma, and Trinity Counties on January 2, 2006, and in Lake County on January 3, 2006, for the severe rainstorms and related events that occurred in those counties in December of 2005 and January of 2006. The President of the United States has declared a state of emergency for the counties listed above except Trinity County on February 3, 2006.

THIS BILL

This bill would add the severe rainstorms and related events that occurred in Del Norte, Humboldt, Lake, Mendocino, Napa, Sonoma, and Trinity Counties in December, 2005, and January, 2006, 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 loss carry forward treatment of losses sustained as a result of those disasters in those counties. For business property, the lesser of the reduction in fair market value or the adjusted basis would apply to disaster losses. The $100 and 10% of AGI imitations 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.

LEGISLATIVE HISTORY

AB 164 (Nava, Stat. 2005, Ch. 623) and SB 457 (Kehoe, Stat. 2005, Ch. 622) allowed taxpayers disaster loss treatment for losses sustained as a result of the severe rainstorms and related events that occurred in Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura Counties.

AB 18 (La Malfa, Stat. 2005, Ch. 624) allowed taxpayers disaster loss treatment for losses sustained as a result of the Shasta County wildfires.

AB 1510 (Kehoe, Stats. 2004, Ch. 772) allowed taxpayers disaster loss treatment for losses sustained as a result of the following 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.

FISCAL IMPACT

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

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Based on data and assumptions discussed below, this provision would result in the following revenue losses.

Estimated Revenue Impact of AB 1798 Effective for Tax Years BOA 1/1/2005 Assumed Immediate Enactment Date		
	(Millions)	
2006/07	2007/08	2008/09
-$0.6	-$1	-$0.7

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

<u>Revenue Discussion</u>

The revenue impact of this provision is dependent on the dollar value of real and personal property losses. The loss for tax purposes is calculated as the lesser of the reduction in fair market value (FMV) or the adjusted basis. This value is reduced by insurance reimbursements, $100 per incident, and 10% of adjusted gross income (AGI).

Preliminary figures from two counties have indicated combined public and private losses of $62 million. Assuming this average is representative of all seven counties, total losses of $435 million ($62 million x 7 counties) in possible real and personal property losses for all counties are estimated. This estimate assumes that real property losses account for 60% or $260 million. This amount is grossed up by 25% to account for personal property losses, totaling $325 million ($260 million + $65 million) in combined losses.

It is estimated that 10% or $32 million of losses are uninsured and 90% or $293 million are insured. Of the insured portion, it is estimated that 70% would be reimbursed by an insurance policy. This results in combined uninsured real and personal property losses of $120 million [$32 million+ ($293 million x 30%)]. These uninsured losses are further reduced by $4 million to account for basis and AGI limitations, resulting in $116 million in possible deductions.

It is estimated that 50% or $58 million in deductions would be used during the year of the disaster and 5% or $6 million will never be reported and therefore would not impact this bill. Assuming an average marginal tax rate of 6% on the remaining $52 million ($116 million - $58 million - $6 million), this bill's revenue loss approximates $3.1 million ($52 million x 6%). If total losses are utilized over a five-year period, the revenue impact for fiscal year 2006/2007 would be $0.6 million.

ARGUMENTS/POLICY CONCERNS

Governor Schwarzenegger also proclaimed a disaster due to the same severe rainstorms for 15 other counties in California. This bill would not apply to the following counties: Sacramento, Butte, El Dorado, Lassen, Marin, Placer, Plumas, San Joaquin, San Mateo, Sierra, Siskiyou, Solano, Sutter, Yolo, and Yuba. The author's staff indicated that these additional counties will be added to the bill when it is subsequently amended.

LEGISLATIVE STAFF CONTACT

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