Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nava	Analyst:	Nicole Kwon	Bill Number:	AB 2735
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	Feb. 24, 2006
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Specified Counties/ December 19, 2005 Rainstorms, Related Flooding & Slides & Any Other 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 the specified counties during the specified period.

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 that began December 19, 2005, in the specified counties.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

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 the following 34 counties on January 2, 3, and 12, 2006: Alameda, Alpine, Amador, Butte, Colusa, Contra Costa, Del Norte, El Dorado, Fresno, Humboldt, Kings, Lake, Lassen, Marin, Mendocino, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, San Luis Obispo, San Mateo, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Trinity, Tulare, Yolo, and Yuba. The President of the United States has declared a state of emergency for all the above counties except Fresno, Kings, and Tulare on February 3, 2006.

THIS BILL

This bill would add the severe rainstorms and related events that occurred in Butte, Del Norte, El Dorado, Humboldt, Lake, Lassen, Marin, Mendocino, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, San Mateo, Sierra, Siskiyou, Solano, Sonoma, Sutter, Trinity, Yolo, and Yuba Counties starting in December 19, 2005, 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 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.

LEGISLATIVE HISTORY

AB 1798 (Berg, 2005/2006) is similar to this bill. AB 1798 includes all of the counties listed in this bill plus 11 additional counties that were also declared to be a disaster by the Governor. AB 1798 is currently in the Assembly Revenue and Taxation Committee.

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

Tax Revenue Estimate

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

Estimated Revenue Impact of AB 2735 Effective for Tax Years BOA 1/1/2005 Assumed Immediate Enactment Date		
	(Millions)	
2006/07	2007/08	2008/09
-$1	-$2	-$2

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

Tax Revenue Discussion

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 AGI.

According to the Federal Emergency Management Agency (FEMA), private, public, and commercial damages are estimated to exceed $500 million statewide for the December 2005 and January 2006 rainstorms. This estimate assumes that total losses equal $550 million and that real and personal property damages account for 70% or $385 million ($550 million x 70%). The counties that would be covered by this bill would be assumed to be about 90% or $347 million ($385 million x 90%) taking in account for those counties not included in this bill.

It is estimated that 10% or $35 million of losses are uninsured and 90% or $312 million are insured. Because some insurance policies cover a fixed amount of damages rather than the fair market value, it is estimated that only 70% of damages would be reimbursed by an insurance policy. These adjustments result in combined uninsured real and personal property losses of $129 million [$35 million + ($312 million X 30%)]. These uninsured losses are reduced by $4 million to account for AGI basis and per incident limitations, resulting in $125 million in possible deductions.

It is estimated that 50% or $63 million in deductions will be used during the year of the disaster and 5% or $6 million will never be reported and therefore will not impact this bill. Assuming an average marginal tax rate of 6% on the remaining $57 million ($125 million - $63 million - $6 million), the revenue loss from the recent storms would be approximately $3.4 million ($57 million x 6%). If total losses are reported over a five-year period, the revenue impact for fiscal year 2006/07 would total $0.7 million loss.

This estimate assumes that the past year's disaster losses are representative of an average year. Therefore, it is assumed that approximately $3.4 million in losses would be generated every year and claimed over the next five-year period. The revenue estimate presented in the chart has been rounded to the nearest million.

ARGUMENTS/POLICY CONCERNS

Governor Schwarzenegger also proclaimed a disaster due to the same severe rainstorms and related events for 11 other counties in California. This bill would not apply to the following counties: Alameda, Alpine, Amador, Colusa, Contra Costa, Fresno, Kings, San Luis Obispo, Santa Cruz, Shasta, and Tulare. The author's staff indicated that these additional counties will be added to the bill when it is subsequently amended.

LEGISLATIVE STAFF CONTACT

Nicole Kwon	Brian Putler
Franchise Tax Board	Franchise Tax Board
845-7800	845-6333
haeyoung.kwon@ftb.ca.gov	brian.putler@ftb.ca.gov