Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Kehoe	Analyst:	Nicole Kwon	Bill Number:	SB 457
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	2-18-2005
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, & Santa Barbara County Severe Rainstorms, Related Flooding, Slides, & Other Events

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 Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Santa Barbara Counties.

This analysis will not address the bill's changes to the Property Tax Law, as they 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 in Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Santa Barbara 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. 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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_______ N	_______ OUA	___X___ PENDING		

A nonbusiness disaster loss not reimbursed by insurance or otherwise is deductible under both state and federal tax law to the extent of two limitations: threshold amount limitation and adjusted gross income limitation. Under the threshold amount limitation, a nonbusiness disaster loss is deductible to the extent the loss exceeds $100. Under the adjusted gross income limitation, 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 loss 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.

BACKGROUND

Governor Schwarzenegger proclaimed a disaster due to the severe rainstorms and related events in Ventura County on January 12, 2005, and in Riverside, Santa Barbara, Los Angeles, Kern, San Bernardino, Orange, and San Diego Counties on January 15, 2005. On February 4, 2005, President Bush declared a disaster in all of the above counties.

THIS BILL

This bill would add the severe rainstorms and related events that occurred in Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Santa Barbara Counties in December of 2004 and January of 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. The $100 and 10% of adjusted gross income limitations in existing law would apply to disaster losses on nonbusiness property.

Due to President Bush's declaration of a major disaster in Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Santa Barbara Counties, this bill would allow the taxpayer to elect to claim the loss either in the year the loss occurred or in the year preceding the loss.

Note: Ventura County is not included in this bill as discussed under Policy Concerns, below.

IMPLEMENTATION CONSIDERATIONS

Once the technical consideration discussed below is resolved, implementing this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

For consistency with other disaster provisions, the author may wish to remove "and related flooding, slides, and other events" on page 7, lines 20 and 21, and on page 10, lines 26 and 27, and replace it with "related flooding and slides, and other related casualties" to identify other events that were connected to and occurred as a result of the severe rainstorms.

LEGISLATIVE HISTORY

AB 18 (La Malfa, 2005/2006) would allow taxpayers disaster loss treatment for losses sustained as a result of the Shasta County wildfires.

AB 164 (Nava, 2005/2006) would allow taxpayers disaster loss treatment for losses sustained as a result of severe rainstorms and related events that occurred in Santa Barbara and Ventura Counties.

AB 1510 (Kehoe, Stat. 2004, Ch. 772) allows 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.

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.

OTHER STATES' INFORMATION

Michigan, Minnesota, Massachusetts, and *New York* conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss. It appears that legislation, executive order, or proclamation by the President or the Governor is required to identify the area impacted by a disaster that is eligible for federal or state assistance.

Florida does not have a personal income tax. However, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. *Florida* also requires legislation, executive order, or proclamation to identify the area impacted by a disaster.

FISCAL IMPACT

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

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Estimated Revenue Impact of SB 457 Assumed Enactment Date After 6/30/05 Fiscal Year Impact		
2005-06	**2006-07**	**2007-08**
a /	a /	a /

a/ Loss of less than $150,000

<u>Revenue Discussion</u>

The impact of this bill would be determined by disaster losses due to personal property damages reported as a deduction in future years. Business property losses do not impact revenues since current law provides carry forward provisions. Once the total amounts of possible deductions are quantified the average marginal tax rate is used to determine the revenue impact.

Preliminary data complied by each county and submitted for state/federal assistance was obtained from the California Office of Emergency Services Department. Since counties are facing challenges in gathering private damage information, weighted averages for each county was calculated according to the preliminary data.

Ventura County was the only county able to provide a current and reasonable estimate of $75 million in private damages. Since current data for each county is not readily available, Ventura County's portion of private damages is adjusted by its weighted average of 37% to reflect total damages of all eight counties. Therefore, the estimate is based on $203 million ($75 million ÷ 37%) in property damages. Total losses are reduced to $128 million ($203 million - $75million) to only reflect the seven counties covered by this bill. The adjustment is made to exclude Ventura County's portion of damages.

Based on the preliminary data for all counties, on average, business losses represent 25% or $32 million ($128 million x 25%) of total losses. This portion will not impact revenues as indicated above.

The remaining 75% is attributable to personal property losses, resulting in approximately $96 million ($128 million x 75%) for personal income tax (PIT) taxpayers. Of the $96 million in total PIT losses, it is estimated that 90% of personal losses are insured. Therefore, uninsured losses are estimated to be $9.6 million ($96 million x 10%).

It is estimated that threshold amount limitations will reduce losses for tax purposes by 1.5% of total PIT losses to $8.2 million ($9.6 million - ($96 million x 1.5% = $1.4million)= $8.2 million). Qualifying losses must further be reduced to reflect adjusted gross income limitations. It is estimated that this limitation represents 1.5% of total PIT losses and reduces the applicable losses to $7.1 million ($8.2 million – ($96 million x 1.5%= $1.4 million) = $6.8 million).

Total losses of $6.8 million may be used in the year prior to the disaster, the year of the disaster, or carried forward to future years. It is estimated that 33% will be used during the year of the disaster and 5% will never be utilized. The other 62%, $4.2 million ($6.8 million x 62%=$4.2 million), will be carried forward and allowed for use in future years. Assuming an average marginal tax rate of 6%, this proposal's total revenue loss approximates $252,000 ($4.2 million x 6% = $252,000). If total losses of $252,000 are carried forward and utilized over a three-year period, the revenue impact is deemed as insignificant.

ARGUMENTS/POLICY CONCERNS

Governor Schwarzenegger and President Bush proclaimed a disaster due to the severe rainstorms and related events to eight counties in Southern California. This bill includes seven of the eight counties, but did not include Ventura County. Therefore, this bill would not apply to Ventura County as introduced.

LEGISLATIVE STAFF CONTACT

Nicole Kwon
Franchise Tax Board
845-7800
haeyoung.kwon@ftb.ca.gov

Brian Putler
Franchise Tax Board
845-6333
brian.putler@ftb.ca.gov