Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Hollingsworth	Analyst:	Angela Raygoza	Bill Number:	SB 1064
Related Bills:	See Legislative History	Telephone:	845-7814	Introduced Date:	January 8, 2008
		Attorney:	Tommy Leung	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/2007 Calendar Year Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura County Wildfires and October 2007 Riverside County Damaging Winds

SUMMARY

This bill would allow special tax treatment, called disaster loss treatment, for losses sustained as a result of the 2007 Southern California Wildfires and wind damage that occurred in October, 2007, in Riverside County.

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 language of the bill, the purpose of this bill is to provide immediate tax relief to individuals and businesses affected by the wildfires and damaging winds.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

POSITION

Pending.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

Under federal and state tax law, a business can deduct losses sustained during the taxable year. In addition, individuals can deduct nonbusiness losses not reimbursed by insurance or otherwise to the extent such losses, after excluding the first $100 of each loss, exceed 10% of the individual's federal adjusted gross income (AGI).

Under federal and state tax 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. The deadline to elect and file an amended return based on federal tax law is before the due date of the return for the taxable year in which the disaster occurred. Current state tax law extends the due date for making the election to six months after the due date of the original return. For state law 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 disaster tax law treatment. The election is not available for a Governor-only declared disaster until enabling state legislation has been enacted.

State tax law identifies specific events as disasters that are then allowed special carry forward treatment for state tax purposes. That special treatment allows 100% of the excess disaster loss to be carried forward for up to fifteen taxable years. For individuals losses the same carry forward rules apply only if the total losses exceed ten percent of the individual’s federal adjusted gross income.

PROGRAM BACKGROUND

Governor Arnold Schwarzenegger proclaimed on October 21, 2007, a state of emergency declaring the wildfires that occurred in Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura counties to be a state disaster. On October 23, 2007, President George W. Bush proclaimed the same counties to be a federal disaster.

On November 2, 2007, Governor Arnold Schwarzenegger proclaimed, the wind damage that occurred in Riverside county in October, 2007, to be a state disaster. President George W. Bush did not declare the Riverside county wind damage a federal disaster

<u>THIS BILL</u>

This bill would add the wildfires that occurred in Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura counties during calendar year 2007 and damage that occurred in the Riverside county during October, 2007, as a result of strong winds, to the current list of specified disasters under the Personal Income Tax (PIT) Law and the Corporation Tax Law (CTL).

As a Presidentially-declared disaster this bill would allow special carry forward treatment for up to fifteen taxable years for losses sustained as a result of the wildfires that occurred in Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura counties during calendar year 2007. The same carry forward rule applies to individual nonbusiness losses if the total losses for the year exceed 10% of the individual’s federal adjusted gross income.

As a Governor-proclaimed disaster, this bill would allow a taxpayer to elect to file an amended return for the prior taxable year and allow special carry forward treatment for up to fifteen taxable years for losses sustained as result of the October, 2007, Riverside county damaging winds. The same carry forward rule applies to individual nonbusiness losses if the total losses for the year exceed 10% of the individual’s federal adjusted gross income.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs or operations.

LEGISLATIVE HISTORY

AB 1759 (Devore, 2007/2008) would allow taxpayers disaster loss treatment for the losses sustained as a result of the 2007 wildfires that occurred in Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura counties. This bill is currently in the first house.

AB 62 (Nava, Stats. 2007, Ch. 224) allows taxpayers disaster loss treatment for losses sustained as a result of the wildfires that occurred in Ventura county in 2006, and in El Dorado, Santa Barbara, and Ventura counties during 2007.

SB 38 (Florez, Stats. 2007, Ch. 222) allows taxpayers disaster loss treatment for losses that occurred as a result of the wildfire in Riverside county in October, 2006.

SB 114 (Florez, Stats. 2007, Ch. 223) allows taxpayers disaster loss treatment for losses that occurred as a result of the freezing conditions that occurred in California in January, 2007. The counties affected by that disaster are El Dorado, Fresno, Imperial, Kern, Kings, Madera, Merced, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Santa Clara, Stanislaus, Tulare, Ventura, and Yuba.

ECONOMIC IMPACT

Revenue Estimate

This bill would have the following revenue impact:

Revenue Analysis for SB 1064 As Introduced January 8, 2008 Effective for Tax Year BOA January 1, 2008				
Fiscal Year	2007-08	2008-09	2009-10	Cumulative Loss
Disaster Relief	Loss < $250,000	Gain < $150,000	Gain < $150,000	Loss < $150,000

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

Revenue Discussion

2007 Southern California Wildfires

The most current data from the Office of Emergency Services (OES) indicates a total of 2,180 structures were destroyed and 482 were damaged as a result of the October, 2007, Southern California Wildfires (total structures = 2,662). Research conducted suggests approximately $1.6 billion of insured property losses were sustained as a result of the targeted wildfires and another $400 million was uninsured for a total of $2 billion in damages.

It is estimated that 90% of uninsured losses would exceed the minimum adjusted gross income threshold resulting in total casualty loss deduction of $360 million ($400 million x 90% = $360 million). The average affected taxpayer would have a potential casualty loss of $135,000 ($360 million ÷ $2,662 structures).

Current law allows taxpayers with disaster losses to amend their 2006 tax returns until April 15, 2008; this bill extends the filing period until October 15, 2008. It is likely that most taxpayers affected by the fires will have filed an amended return claiming their fire losses under current law by April 15th to get an accelerated refund. Based on expectations about taxpayer filing behavior, it is assumed that 1% of the value of casualty losses would be filed on an amended 2006 return and that half of those losses would be used to offset reported income. The revenue loss accrued to 2007-08 would be approximately $162,000 ($360 million x .01 assumption rate x .50 of the losses x .09 marginal rate = $162,000), a negligible loss of less than $250,000. To the extent these deductions would have been claimed in later years had they not been taken in 2006, there is an insignificant revenue gain in those later years. Therefore, for 2008-09 and 2009-10, there would be insignificant revenue gains of less than $150,000 in each year, resulting in an insignificant net revenue loss for the three-year period of less than $150,000.

Under current law, affected taxpayers have ten years to deduct their disaster losses. Given that the average casualty loss for the fires is estimated to be $135,000, it is unlikely that many taxpayers will have losses remaining after 10 years. Therefore, the long-term revenue effect of the additional five years of carryover beyond the ten years currently allowed is assumed to be insignificant.

Riverside County Wind damage

The Governor’s proclamation indicated that the extremely high winds in Riverside County “have caused over six million dollars in public facility damage”. Uninsured losses represent 20% of the total losses, resulting in uninsured losses of $1.2 million ($6 million x.20 = $1.2 million). The average taxpayer has a casualty loss of $10,000.

Based on expectations about taxpayer filing behavior it is assumed that 25% of the value of casualty losses would be filed on an amended 2006 return and that 90% of those losses would exceed the minimum adjusted gross income threshold. The result would be an accrued revenue loss for 2007-08 of $27,000 ($1.2 million x .25 x.09 = $27,000), an insignificant loss of less than $150,000.

Under current law, affected taxpayers have ten years to deduct their disaster losses. Given that the average casualty loss for the winds is less than $10,000, it is unlikely that many taxpayers will have losses remaining after 10 years. Therefore, the long-term revenue effect of the additional five years of carryover beyond the ten years currently allowed is assumed to be insignificant.

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