**Franchise Tax Board**

# ANALYSIS OF ORIGINAL BILL

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| Author: | Houston/Galgiani | Analyst: | Gail Hall | Bill Number: | AB 135 |
| Related Bills: | See Legislative History | Telephone: | 845-6111 | Introduced Date: | January 16, 2007 |
| | | Attorney: | Patrick Kusiak | Sponsor: | |

**SUBJECT**: Net Operating Loss Deduction/Allow Carryover For 20 Years Beginning On Or After January 1, 2007.


## SUMMARY

This bill would increase the carryover period for net operating losses (NOLs) to 20 years under the personal income tax and corporation tax law.


## PURPOSE OF THE BILL

It appears the purpose of the bill is to conform to the federal NOL carryover period of 20 years.

## EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would specifically apply to net operating losses attributable to taxable years beginning on or after January 1, 2007.

## POSITION

Pending.

## ANALYSIS

FEDERAL LAW

When a taxpayer has an operating loss for the tax year, the operating loss that may be used in subsequent years is called an NOL. An operating loss occurs when a taxpayer's allowed deductions exceed their gross income for that year. Federal law provides, in general, that an NOL can be carried back two years and forward 20 years, and deducted. Special rules are provided for the carryback of NOLs relating to issues such as specified liability losses, casualty or theft losses, disaster losses of a small business, and farming losses.

STATE LAW

In general, a California taxpayer calculates its NOL in accordance with federal rules. One difference is that California does not allow the carryback of NOLs. Depending on the type of taxpayer or amount of a taxpayer's income, the amount of NOL that is eligible to be carried forward and the numbers of years it can be carried forward will vary.

| Board Position: | | | Department Director | Date |
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| ______ S | ______ NA | ______ NP | | |
| ______ SA | ______ O | ______ NAR | Selvi Stanislaus | 2/7/07 |
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The taxpayer must make an election from the following list as to the type of NOL the taxpayer has incurred.

Existing state law provides for the following types of NOLs:

| Type of NOL and Description | NOL % Allowed To Be Carried Over | Carryover Period (Current State Law) |
|---|---|---|
| General NOL | 100% | 10 Years |
| New Business NOL | 100% | 10 Years |
| Eligible Small Business | 100% | 10 Years |
| Specified Disaster Loss | 100% | 15 Years |
| Pierce's Disease | 100% | 9 Years |
| Economic Development Areas | 100% | 15 Years |

## THIS BILL

This bill would extend the period to utilize a net operating loss carryover to 20 years under the personal income tax and corporation tax law. This bill would apply to the types of NOLs described in the chart above with the exception of specific disaster losses.

## IMPLEMENTATION CONSIDERATIONS

This bill would not significantly impact the department's programs and operations.

## TECHNICAL CONSIDERATIONS

The department has identified the following technical consideration. Department staff is available to work with the author's office to resolve this and other concerns that may be identified.

The author may wish to consider amending specific provisions of current law[1] to extend the NOL carryover period instead of creating a new provision of state law. This would provide clarity and be consistent with the manner in which prior NOL carryover amendments were made to state law.

## TAX POLICY CONSIDERATIONS

This bill would conform the state NOL carryover period to the federal carryover period, thereby, simplifying the preparation of California tax returns.

[1] Revenue & Taxation Code Sections 17276, 17276.7, 24416, and 24416.7.

## LEGISLATIVE HISTORY

There have been numerous bills that have proposed completely conforming to federal NOL law, especially during the 2001/2002 legislative sessions. Below are examples of some of these proposed bills:

AB 91 (Zettel, 2001/2002) would have conformed state law to federal tax law on NOLs, including allowing an NOL to be carried back, increasing the time period for carryovers, and allowing 100% of an NOL to be claimed. AB 91 failed to pass out of the Assembly Revenue and Taxation Committee.

AB 339 (Correa, 2001/2002) would have conformed the personal income tax law and corporation tax law to the federal NOL provisions. Specifically, this bill would have allowed taxpayers to carry forward 100% of the NOL to offset the income of the 20 taxable years following the taxable year of the loss. However, this bill would not allow the NOL to be carried back. AB 339 failed to pass out of the Assembly Appropriations Committee.

SB 607 (Oller, 2001/2002) would have conformed state law to federal NOL tax law, including allowing an NOL to be carried back. SB 607 failed to pass out of the Senate Revenue and Taxation Committee.

## OTHER STATES' INFORMATION

The states surveyed include *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

- *Florida* income tax law, applicable only to corporations, provides a 20-year NOL carryover period.
- *Illinois* provides a 20-year NOL carryover period for both personal income tax and corporation taxpayers.
- *Massachusetts* income tax law disallows NOL treatment for personal income taxpayers, but corporations are allowed a five-year NOL carryover period.
- *Michigan* provides a 20-year NOL carryover period for personal income taxpayers but has no NOL carryover provision relating to the Michigan Single Business Entity Tax.
- *Minnesota* provides a 20-year NOL carryover period for personal income taxpayers and a 15-year NOL carryover period for corporation taxpayers.
- *New York* provides a 20-year NOL carryover period for both personal income tax and corporation taxpayers.

## FISCAL IMPACT

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

**ECONOMIC IMPACT**

Revenue Estimate

| Revenue Impact of AB 135 (Extending the Carryover Years to 20) Enactment Assumed After June 30, 2007 ($ in Millions) | | | | |
|---|---|---|---|---|
| | 2007-08 | 2008-09 | 2009-16 | 2017-18 |
| Revenue Impact | $0 | $0 | $0 | -30 |

Revenue Discussion

The revenue impact of this bill would occur beginning with fiscal year 2017-18, assuming the average NOL carryover period is 10 years. The reason for the delay in revenue impact is because under current law NOLs generated in 2007 could potentially be used up through fiscal year 2017. Under this bill, these losses could be used in the fiscal years 2018 through 2027, thus creating an extended period upon which NOLs could be utilized. Using company-level data and micro-simulation model, it is estimated that $600 million of NOLs generated in 2007 would be used in 2018. Using an estimated tax rate of five percent, the estimated revenue loss for fiscal year 2017-18 would be $30 million.

Similarly, this bill would allow losses generated in 2008 to potentially be used from 2019 through 2028. The revenue impact of the bill would be small in 2018 because only 2007 NOLs could be used in that year. The amount of NOLs that could potentially be used would increase in subsequent years as losses generated in 2008 and beyond may be used. Taking into account the losses generated after 2007, the sum of all the NOLs carried forward would reach four billion dollars in 2027. At a tax rate of five percent, this would result in a revenue loss of $200 million in 2027.

**LEGISLATIVE STAFF CONTACT**

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