Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	De Leon	Analyst:	Gail Hall	Bill Number:	AB 1511
Related Bills:	See Legislative History	Telephone:	845-6111	Amended Date:	July 15, 2010
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: NOL/Disaster Loss/Credit Sharing/Sales Factor

SUMMARY

This bill would do the following:

Provision No. 1: Remove the net operating loss (NOL) carryback provisions and suspend NOL deductions for 2 additional years.

Provision No. 2: Make certain federal law sections, relating to the carryback of NOLs attributable to disaster losses, inapplicable for state purposes.

Provision No. 3: Delay the use of assigned tax credits.

Provision No. 4: Remove the election provision from the single factor, 100 percent sales apportionment formula (single sales factor), and make this formula mandatory to determine business income derived from within and without California.

SUMMARY OF AMENDMENTS

The July 15, 2010, amendments made the following changes to the bill:

- Removed the bill's provisions relating to the Education Code.
- Removed the NOL carryback provisions under current state Personal Income Tax Law (PITL) and Corporation Tax Law (CTL) that would have applied to 2011 and later losses.
- Moved current law's 20-year NOL carryover period provisions under PITL and CTL into a new section of law.
- Suspended NOL deductions for taxable years beginning on or after January 1, 2010, and before January 1, 2012.
- Made the federal disaster NOL carryback rules inapplicable for state purposes.
- Repealed current law's tax credit assignment provisions and enacted almost identical tax credit assignment provisions into a new section of law with a delayed operative date for the usage of an assigned tax credit.
- Repealed the elective single sales factor apportionment formula and replaced it with a new section of law that would require a mandatory single sales factor with a delayed operative date.

This is the department's first analysis of this bill.

Board Position:			Department Director	Date
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_______ N	_______ OUA	___X___ PENDING		

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would take effect immediately upon enactment. The operative dates of these changes vary and will be addressed separately for each provision.

POSITION

Pending.

ECONOMIC IMPACT - SUMMARY REVENUE TABLE

Estimated Revenue Impact of AB 1511 Enactment assumed after 6/30/2010 ($ In Millions)				
	2010-11	2011-12	2012-13	2013-14
Provision No. 1: Repeal NOL Carrybacks, Suspend NOL Deductions for 2010 and 2011	$1,500	$400	-$400	-$44
Provision No. 2: Disaster Losses	0	0	0	0
Provision No. 3: Repeal Credit Sharing Provision. Create new provision operative for tax years beginning on or after 1/1/2012	$24	$23	-$3	-$6
Provision No. 4: Repeal Elective Single Sales Factor. Adopt Mandatory Single Sales Factor Apportionment operative for tax years beginning on or after 1/1/2012	$270	$850	$1,000	$850
Interaction between these provisions	$44	$72	-$4	-$1
Total Revenue Impact	$1,838	$1,345	$593	$799

PROVISION NO. 1: REPEAL NOL CARRYBACKS/SUSPEND NOLS/ADD SEPARATE NOL CARRYOVER SECTION

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be effective immediately upon enactment and would be operative as follows:

1. Repeal NOL Carrybacks: operative for taxable years beginning on or after January 1, 2010.
2. Suspension of NOLs: operative for taxable years beginning on or after January 1, 2010, and before January 1, 2012.
3. Creation of a new NOL carryover period section: operative for NOLs attributable to taxable years beginning on or after January 1, 2008.

ANALYSIS

FEDERAL LAW

When a taxpayer has an operating loss for a taxable year, the operating loss amount that may be deducted in other tax 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 2 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. For NOLs arising in tax years ending after December 31, 2007, an eligible small business can elect to increase the NOL carryback period for an applicable 2008 or 2009 NOL from 2 years to 3, 4, or 5 years.

STATE LAW

In general, a California taxpayer calculates its NOL in accordance with federal rules. For NOLs attributable to taxable years beginning before January 1, 2008, California limits the carryforward period to 10 years in circumstances where federal law allows 20 years. For NOLs attributable to taxable years beginning before January 1, 2011, NOL carrybacks are disallowed.

NOLs attributable to taxable years beginning on or after January 1, 2008, may be carried forward 20 years. California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2011, with the following modifications:

1. An NOL may be carried back only 2 years. (Federal law has special rules that in some cases allow an NOL to be carried back for a longer period).
2. The amount of NOL carryback attributable to taxable year 2011 is limited to 50 percent of the NOL.
3. The amount of NOL carryback attributable to taxable year 2012 is limited to 75 percent of the NOL.

Current state law conforms to the federal carryback period for a Real Estate Investment Trust and a corporate equity reduction interest loss, which is zero.

NOL deductions are suspended for taxable years 2008 and 2009 for a taxpayer with net business income (PITL) and income subject to tax (CTL) of $500,000 or more.

- For PITL, "net business income" means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (partnership or S corporation), income from rental activity, and income attributable to a farming business.

The NOL carryforward period is extended two years for an NOL suspended in tax year 2008 and one year for an NOL suspended in tax year 2009.

THIS PROVISION

This provision applies to both PITL and the CTL and would make the following changes:

- Remove the NOL carryback provisions under current state law, which would have the effect of making the carryback provisions never operative for state purposes.
- Disallow NOL deductions for two additional years by suspending them for taxable years 2010 and 2011 for a taxpayer with net business income (PITL) and income subject to tax (CTL) of $500,000 or more. The NOL carryforward period would be extended two years for an NOL suspended in tax year 2010 and one year for an NOL suspended in tax year 2011.
- Move the 20-year carryforward provisions under current law from one section of the law to another section.

FISCAL IMPACT

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

ECONOMIC IMPACT

Estimated Revenue Impact of Provision No. 1 Enactment assumed after 6/30/2010 ($ In Millions)				
	2010-11	2011-12	2012-13	2013-14
Provision No. 1: Repeal NOL Carrybacks, Suspend NOL Deductions for 2010 and 2011	$1,500	$400	-$400	-$44

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

PROVISION NO. 2: DISASTER LOSSES

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2010.

ANALYSIS

Federal/State Law

A disaster loss occurs when business or personal property is completely or partially destroyed as a result of a fire, storm, flood, or other natural event in an area declared to be a disaster by the President of the United States. The deduction of a disaster loss can create an NOL.

In general, a federal NOL may be carried back 2 years and carried forward 20 years to offset taxable income in other tax years. Different rules apply with respect to NOLs arising in certain circumstances such as losses attributable to disasters.

Internal Revenue Code (IRC) 172(j) provides a special 5-year carryback period for NOLs attributable to "qualified disaster losses." IRC 172(b)(1)(J) defines a "qualified disaster loss" as the lesser of:

1. the sum of:
    - A. losses for a taxable year attributable to a Federally declared disaster occurring in a disaster area occurring before January 1, 2010, and
    - B. the allowable deduction for the taxable year for qualified disaster expenses.
2. the NOL for the taxable year.

California generally follows federal law regarding the treatment of losses incurred as a result of a disaster, unless California enacts legislation for special disaster loss treatment.[1] If California enacts legislation for special disaster loss treatment, the disaster losses are not eligible for California NOL treatment, as they would be under federal law; however, a taxpayer may elect to deduct a qualified disaster loss either on an amended tax return for the tax year preceding the year of the disaster or on the tax return filed for the year of the disaster 100% of the excess disaster loss may be carried forward for 15 years. Although, under current state law, no NOL carrybacks are allowed for losses attributable to taxable years beginning before January 1, 2011.

THIS PROVISION

This provision would provide that IRC 172(j), relating to the special 5-year carryback period for NOLs attributable to "qualified disaster losses," and IRC 172(b)(1)(J), relating to definitions and rules for the 5-year carryback period, shall not apply for California purposes.

TECHNICAL CONSIDERATION

The provisions added by this bill that would make IRC 172(j) and IRC 172(b)(1)(J)[2] inapplicable for state purposes are unnecessary because these federal sections apply to taxable years beginning before January 1, 2010, and California law already disallows NOL carrybacks for losses attributable to taxable years beginning before January 1, 2011.

FISCAL IMPACT

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

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[1] Revenue and Taxation Code (R&TC) Section 17207.
[2] See the Federal/State Law discussion in this analysis for an explanation of IRC 172(j) and IRC 172(b)(1)(J).

ECONOMIC IMPACT

Estimated Revenue Impact of Provision No. 2 Enactment assumed after 6/30/2010 ($ In Millions)				
	2010-11	2011-12	2012-13	2013-14
Provision No. 2: Disaster Losses	0	0	0	0

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

PROVISION NO. 3: DELAY USE OF ASSIGNED TAX CREDITS

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be effective immediately upon enactment and operative as follows:

- Repeal of current law's credit assignment provision: operative for taxable years beginning on or after January 1, 2010.
- New credit assignment provision: Specifically allows the assignment of any credit allowed to a taxpayer in taxable years beginning on or after July 1, 2008. In addition, this provision specifically prevents an assigned credit from being used to reduce the tax for a taxable year beginning before January 1, 2012.

ANALYSIS

FEDERAL/STATE LAW

Current federal law does not permit the assignment of tax credits among taxpayers.

Current state CTL allows the assignment of certain credits to taxpayers that are members of a combined reporting group and includes the following provisions:

- An "eligible credit" may be assigned by a taxpayer to an "eligible assignee."
  - "Eligible credit" means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, that is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008.
  - "Eligible assignee" means any "affiliated corporation" that is properly treated as a member of the same combined reporting group.
  - "Affiliated corporation" means a corporation that is a member of a commonly controlled group.

- An assigned credit may reduce tax for a taxable year beginning on or after January 1, 2010.
- The election to assign any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.
- The FTB is required to issue a report on or before June 30, 2013, to the Joint Legislative Budget Committee, the Legislative Analyst, and relevant policy committees.

THIS PROVISION

This provision would repeal current law's assignment of tax credit provisions, but would add into a new section identical law except that an assigned credit could only reduce the tax for a taxable year beginning on or after January 1, 2012. In addition, the report required to be issued by the FTB would be due on or before June 30, 2015.

IMPLEMENTATION CONSIDERATION

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

- This bill is silent on whether any tax credit assignments made prior to the effective date of this bill would be subject to the bill's provision that assigned tax credits may only reduce tax for taxable years beginning on or after January 1, 2012. Alternatively, the bill could be read to allow previous tax credit assignments to reduce the tax for taxable years beginning on or after January 1, 2010. It is recommended that the author add legislative intent language clarifying their intent as to this question.

FISCAL IMPACT

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

ECONOMIC IMPACT

Estimated Revenue Impact of Provision No. 3 Enactment assumed after 6/30/2010 ($ In Millions)				
	2010-11	2011-12	2012-13	2013-14
Provision No. 3: Repeal Credit Sharing Provision. Create new provision operative for tax years beginning on or after 1/1/2012	$24	$23	-$3	-$6

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

PROVISION NO. 4: SINGLE FACTOR, 100% SALES FORMULA

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be effective immediately, and would repeal the elective single sales factor operative for taxable years beginning on or after January 1, 2011. In addition, this provision would add a mandatory single sales factor provision that would be specifically operative for taxable years beginning on or after January 1, 2012.

ANALYSIS

FEDERAL/STATE LAW

The federal method of taxing corporations doing business within and without the United States is different from the California method for taxing corporations doing business within and without the state; therefore, federal law is inapplicable.

California has adopted the Uniform Division of Income for Tax Purposes Act (UDITPA), with certain modifications, to determine how much of an apportioning taxpayer's total income, which is earned from activities both inside and outside of California, is attributed to California and subject to California franchise or income tax. UDITPA uses an apportionment formula to determine the amount of "business" income attributable to California.

The apportionment formula consists of property, payroll, and sales factors. Each of these factors is a fraction the numerator of which is the value of the item in California and the denominator of which is the value of the item everywhere. The property factor includes tangible property owned or rented during the taxable year; the payroll factor includes all forms of compensation paid to employees; and the sales factor generally includes all gross receipts from the sale of tangible and intangible property. For most taxpayers, the sales factor is double-weighted.

The calculation of this apportionment formula and California business income is illustrated below.

$$\frac{\boxed{\dfrac{\text{Average CA Property}}{\text{Average Total Property Everywhere}}} + \boxed{\dfrac{\text{CA Payroll}}{\text{Total Payroll Everywhere}}} + \left(2 \text{ X } \boxed{\dfrac{\text{CA Sales}}{\text{Total Sales Everywhere}}}\right)}{4} = \text{California Apportionment Percentage}$$

X Total Business Income
= California Business Income

For taxable years beginning on or after January 1, 1993, the apportionment formula for most taxpayers has been a three-factor apportionment formula consisting of property, payroll, and double-weighted sales (three-factor, double-weighted sales). An exception to this rule exists for taxpayers of an apportioning trade or business that derive more than 50 percent of its gross business receipts from conducting a “qualified business activity.” These taxpayers are required to use a three-factor, single-weighted sales, apportionment formula. For this purpose, a qualified business activity is defined as an agricultural, extractive, savings and loan, and banking or financial business activity. In addition, current law requires that once a determination has been made that the apportioning trade or business is involved in a qualified business activity, all members of the apportioning trade or business use the same weighting, regardless of whether the particular entity was involved in a qualified business activity.

State law permits a departure from the standard apportionment provisions only in limited and specific cases[3], and recognizes that the standard apportionment provisions are not appropriate when applied to certain industries and types of transactions, in which case special apportionment provisions exist for those situations[4].

For taxable years beginning on or after January 1, 2011, state law allows an apportioning trade or business to make an annual, irrevocable election to utilize a single sales factor instead of the three factor, double-weighted sales apportionment formula. Qualified business activities (described above) are specifically prohibited from electing a single sales factor. The election must be made on a timely filed original return in the manner and form prescribed by the Franchise Tax Board.

<u>THIS PROVISION</u>

This provision would repeal current law that allows an apportioning trade or business to elect to utilize the single sales factor for taxable years beginning on or after January 1, 2011. In addition, this provision adds a single sales factor provision that would provide that each apportioning trade or business, except for those that derive more than 50 percent of their gross receipts from conducting a “qualified business activity,” would be required to apportion business income by using the single sales factor.

TECHNICAL CONSIDERATION

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

Section 25128 of the Revenue and Taxation Code (R&TC) references R&TC Section 25128.5, which would be repealed by this bill. The reference should be changed to Section 25128.7.

FISCAL IMPACT

This provision would not significantly impact the department’s costs.

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[3] Revenue and Taxation Code (R&TC) section 25137.
[4] California Code of Regulations (CCR), title 18, Section 25137.

ECONOMIC IMPACT

Estimated Revenue Impact of Provision No. 4 Enactment assumed after 6/30/2010 ($ In Millions)				
	2010-11	2011-12	2012-13	2013-14
Provision No. 4: Repeal Elective Single Sales Factor. Adopt Mandatory Single Sales Factor Apportionment operative for tax years beginning on or after 1/1/2012	$270	$850	$1,000	$850

This analysis does not account for changes in employment, personal income, or gross state product that could result from this provision.

LEGISLATIVE HISTORY

AB 1935 (De Leon, 2009/2010) would remove the elective language for the single sales factor formula and require each apportioning trade or business, except for those that derive more than 50 percent of their gross receipts from conducting a "qualified business activity," to apportion business income by using the single sales factor formula. AB 1935 is currently at the Assembly Appropriations Committee.

AB 1936 (De Leon, 2009/2010) would remove the NOL carryback provisions under current state law. AB 1936 is currently at the Assembly Appropriations Committee.

SBX3 15 (Calderon, Stats. 2010, 3rd Ex. Sess. 2009, Ch. 17) and ABX3 15 (Krekorian, Stats. 2010, 3rd Ex. Sess. 2009, Ch. 10) enacted a provision that allows certain apportioning trades or businesses to make an annual, irrevocable election on a timely filed original return to utilize a single sales factor apportionment formula instead of the three factor, double-weighted sales apportionment formula. Apportioning trades or businesses that derive more than 50 percent of their gross business receipts from conducting one or more qualified business activities (agricultural, extractive, savings and loan, and banking or financial business) are specifically prohibited from electing a single sales factor apportionment formula.

AB 1452 (Assembly Budget Committee, Stats. 2008, Ch. 763) enacted the 2-year NOL carryback and assignment of tax credit provisions along with provisions that authorized the Franchise Tax Board to conduct a tax amnesty (this piece was later repealed), allows an NOL carryover period of 20 years, suspends NOL deductions for two years, limits the amount of tax credits that may reduce tax for two years, and requires Limited Liability Corporations (LLCs) to estimate and pay LLC fee by a specific date of the taxable year.

LEGAL CONCERN

It is unclear what impact, if any, Proposition 24, which qualified for the November 10, 2010, ballot, would have on this bill should both be enacted..

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