Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Caballero	Analyst:	Gail Hall	Bill Number:	AB 829
Related Bills:	See Legislative History	Telephone:	845-6111	Amended Date:	May 26, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Net Operating Loss Carrybacks/Repeal For Losses Incurred On Or After January 1, 2011/Change Single Sales Factor Election To 7 Years Operative January 1, 2011

SUMMARY

This bill would repeal the net operating loss (NOL) carryback provisions and change the election period for the sales factor only formula utilized to apportion income.

This analysis will not address the bill's sales and use tax provision, as it does not impact the department or state income tax revenue.

SUMMARY OF AMENDMENTS

The May 26, 2009, amendments added the following provisions to the bill:

Provision No. 1: Repealed the NOL carryback provisions in current law.

Provision No. 2: Revised the election period for the sales factor only apportionment formula.

In addition, the May 26, 2009, amendments removed the provisions of the bill that would create a credit for sales or use tax paid on the purchase of tangible property by qualified manufacturers.

EFFECTIVE/OPERATIVE DATE

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

POSITION

Pending.

ECONOMIC IMPACT

Due to resource constraints and workload prioritization, a revenue impact for this bill was not developed.

Board Position:			Department Director	Date
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PROVISION 1: NOL CARRYBACKS

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be immediately effective upon enactment and would be operative for taxable years beginning on or after January 1, 2009.

ANALYSIS

FEDERAL LAW

When a taxpayer has a net operating loss for the taxable year, the operating loss that may be deducted in subsequent years is called a 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 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 (REIT) and a corporate equity reduction interest loss, which is zero.

THIS PROVISION

This provision would remove the NOL carryback provisions under current state law.

LEGISLATIVE HISTORY

SB 76 (Senate Committee on Budget, 2009/2010) would repeal the NOL carryback provisions and end the assignment of tax credits between members of a group. SB 76 was placed on inactive file on request of Assembly Member Torrico.

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

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, Illinois, Massachusetts, Michigan, and Minnesota disallows NOL carrybacks, but *New York* generally follows the federal rules for NOLs but places a $10,000 limit on carrybacks.

FISCAL IMPACT

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

PROVISION 2: SALES ONLY FORMULA ELECTION PERIOD

EFFECTIVE/OPERATIVE DATE

As a tax levy, this provision would be immediately effective upon enactment and apply to the sales only formula provisions that are specifically operative for taxable years beginning on or after January 1, 2011.

ANALYSIS

<u>FEDERAL/STATE LAW</u>

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.

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[1], 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[2].

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 factor, 100 percent sales, (single sales factor) apportionment formula instead of the three factor, double-weighted sales apportionment formula. Qualified business activities (described above) would be specifically prohibited from electing a single sales factor apportionment formula. The election would be made on a timely filed original return in the manner and form prescribed by the FTB.

THIS PROVISION

This provision would remove the annual election for the single sales factor and provide that each contract making an election would be binding for a period of 84 months.

IMPLEMENTATION/TECHNICAL CONSIDERATIONS

Due to resource constraints and workload prioritization, implementation and technical considerations for this provision were not developed.

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

LEGISLATIVE HISTORY

SBX3 15 (Stats. 2009, Ch. 09X3-17) 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 factor, 100 percent sales 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 factor, 100 percent sales apportionment formula.

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.

In general, *Florida and Massachusetts* utilize a three-factor, double-weighted sales, apportionment formula.

In general, *Illinois, Michigan, Minnesota (phased-in 2014), and New York* utilize a mandatory single sales factor, therefore, no election is necessary.

FISCAL IMPACT

Due to resource constraints and workload prioritization, a fiscal impact for this provision was not developed.

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