Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Harkey | Analyst: Gail Hall | Bill Number: AB 876

Related Bills: See Prior Analysis | Telephone: 845-6111 | Amended Date: May 5, 2009

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: Exclusion/Gain From Sale Or Exchange Of Capital Asset Purchased During 2009 And 2010 Calendar Year & Held More Than One Year/Prohibit Capital Losses

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ______________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

__X__ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ______________.

__X__ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ______________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 14, 2009, STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This bill would change the rules for including capital gains and losses in gross income.

SUMMARY OF AMENDMENTS

The May 5, 2009, amendments made the following changes:

- Added that capital assets purchased in calendar year 2010 would qualify for the capital gain exclusion.
- Added provisions relating to capital losses.
- Resulted in an additional implementation consideration.

Except for the EFFECTIVE/OPERATIVE DATE, THIS BILL, IMPLEMENTATION CONSIDERATIONS, and ECONOMIC IMPACT discussion, the department's analysis of the bill as amended April 14, 2009, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	05/12/09
____ N	____ OUA	__X__ PENDING		

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be specifically operative for taxable years beginning on or after January 1, 2009, but would only apply to capital gains from the sale of a capital asset purchased in calendar year 2009 or 2010 and held for more than one year. As a result, only gains from sales of capital assets in 2010 and thereafter would qualify under this bill's provisions. In addition, net capital losses for any capital asset purchased in 2009 and 2010 would not be allowed.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

The discussion below supplements the FEDERAL and STATE LAW sections of the department's analysis of the bill as amended April 14, 2009.

Federal Law

When a capital asset is sold, and the adjusted basis, which is usually what was paid for the asset, is greater than the selling price, there is a capital loss.

In general, a corporation may deduct capital losses only to the extent of their capital gains. Excess capital losses are carried back three years and the carryforward period is five years.

In general, a noncorporate taxpayer may deduct capital losses only to the extent of capital gains plus the lower of $3,000 or the excess of the capital losses over the capital gains. Excess capital losses are carried forward indefinitely until absorbed, but carrybacks are disallowed.

State Law

State law conforms to the federal capital loss provisions except that the carryback of a capital loss is disallowed.

THIS BILL

This bill would exclude from gross income the gain on the sale or exchange of a capital asset purchased in calendar year 2009 or 2010, and held more than one year. In addition, this bill would disallow net capital losses with respect to any capital asset that is purchased during the 2009 and 2010 calendar year. The bill applies to PITL and CTL.

IMPLEMENTATION CONSIDERATIONS

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

1. This bill has no requirement for the netting of capital gains and losses before determining the amount of capital gain exclusion. This conflicts with current federal and state laws relating to capital gains and losses. If it is the author's intent to maintain the current netting rules for capital gains and losses, amendments would be necessary.

2. This bill's provision that disallows "net capital losses" with respect to "any capital asset" is internally inconsistent. "Net capital losses" refer to the excess capital losses over capital gains for multiple capital assets, whereas "any capital asset" refers to a single capital asset. Amendments would be necessary to remove this inconsistency.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill is estimated to be as shown in the following table:

Estimated Revenue Impact of AB 876 Effective for Taxable years BOA 1/1/2009 Enacted after 6/1/2009			
2009-10	2010-11	2011-12	2012-13
-$130 Million	-$590 Million	-$1.15 Billion	-$1.375 Billion

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

Revenue Discussion

The revenue impact was estimated using a microsimulation model. This model simulates the tax liability of each individual taxpayer under current and proposed tax laws based on personal and financial data such as filing status, taxable income, capital gains, and tax rates. Included below is an explanation of how the 2009/2010 fiscal year revenue estimate was calculated. The same process was applied to fiscal years 2010/2011, 2011/2012, and 2012/2013 fiscal years.

The fiscal year 2009/2010 revenue impact was estimated as follows:

First, data was gathered from a sample of 2007 personal income tax (PIT) returns. Simulation results show that the amount of PIT on capital gains, including the disallowance of capital losses, is $10.503 billion for the 2007 taxable year. The $10.503 billion was extrapolated to $5.317 billion for taxable year 2010 based on the Department of Finance's (DOF) forecast of capital gain income.[1] Only fractions of future taxes on capital gains come from assets purchased in 2009. These fractions vary by year, and are estimated using the holding period data from the 2007 capital gain sample. It was estimated that for tax year 2010, approximately 6 percent, or $319 million of 2010's total tax on capital gains would come from assets purchased in 2009 ($5.317 billion x 6% ≈ $319 million).

Second, the $319 million estimated tax from capital gains for taxable year 2010 was adjusted downward to account for potential increases of sales of capital assets due to the exclusion provision under this bill. In addition, the estimate was adjusted upward to account for the surcharge of 0.25 percent in PIT tax rates for the 2009 and 2010 taxable years. The revenue impact for individuals was adjusted upward to account for the additional impact of this bill on corporations and partnerships. The revenue impact for corporations and partnerships was assumed to equal 6.6 and 5 percent of the impact for individuals respectively. These adjustments reduce the estimated 2010 revenue loss from $319 million to $308 million, an adjustment of approximately 3 percent.

Third, the $308 million revenue loss was converted to fiscal year estimates as shown in the table above. It was estimated that 42 percent or approximately $130 million of the $308 million revenue loss would be realized in fiscal year 2009/2010, and 58 percent, or approximately $178 million would be realized in fiscal year 2010/2011.

LEGISLATIVE STAFF CONTACT

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[1] DOF Forecast For Capital Gain Income: -55%, -10%, +25%, and +21% for 2008, 2009, 2010, and 2011, respectively.