

Franchise Tax Board

**ANALYSIS OF AMENDED BILL**

Author: Feuer Analyst: David Scott Bill Number: AB 1276

Related Bills: None Telephone: 845-5806 Amended Date: March 31, 2011

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Business Expense Deduction/Disallow Deduction For Punitive Damages Beginning January 1, 2012

**SUMMARY**

The bill would disallow an income or franchise tax deduction related to punitive damages.

**RECOMMENDATION AND SUPPORTING ARGUMENTS**

No position.

**Summary of Amendments**

The March 31, 2011, amendments deleted the nonsubstantive changes to the Revenue and Taxation Code provisions that disallow a deduction for membership in clubs that restrict membership and added the provisions discussed in this analysis.

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

**PURPOSE OF THE BILL**

The purpose of this bill appears to be to require a taxpayer that is the subject of a punitive damage award to bear the entire cost of the judgment or settlement by repealing the deduction for punitive damages.

**EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2012.

Board Position:	Executive Officer	Date
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## **ANALYSIS**

### **FEDERAL/STATE LAW**

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business, unless specifically excluded by statute. No deduction is allowed for any fine or similar penalty paid to a government for a violation of law. Individuals are allowed to deduct ordinary and necessary expenses paid or incurred for the production of income and for the management, conservation, or maintenance of property held for the production of income. The expenses must not be a nondeductible personal living expense or exceed specific statutory limits. Punitive damages that are paid as a result of a judgment or settlement against a taxpayer in connection with the operation of a trade or business or the production of income or the management, conservation, or maintenance of property held for the production of income may be deductible as ordinary and necessary expenses.

### **THIS BILL**

This bill would disallow the deduction of punitive damages paid or incurred in connection with any judgment in or settlement of any action under the Personal Income Tax Law or the Corporation Tax Law.

### **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.

All six states follow the federal rules that allow the deduction of punitive damages.

### **FISCAL IMPACT**

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

### **ECONOMIC IMPACT**

#### **Revenue Estimate**

Estimated Revenue Impact of AB 1276 For Taxable Years Beginning On or After January 1, 2012 Enactment Assumed After June 30, 2011		
2011-12	2012-13	2013-14
\$0	\$1,800,000	\$1,300,000

## **SUPPORT/OPPOSITION**

Support: none provided.

Opposition: none provided.

## **ARGUMENTS**

Pro: Punitive damages are designed to punish a defendant and change unwanted behavior. Proponents might argue that the current ability to deduct punitive damages supports a behavior or act that resulted in the paying of punitive damages.

Con: Opponents might argue that with the state's current fiscal crisis, the loss of the ability to deduct any punitive damages would place additional financial burdens on affected taxpayers.

## **LEGISLATIVE STAFF CONTACT**

David Scott  
Legislative Analyst, FTB  
(916) 845-5806  
[david.scott@ftb.ca.gov](mailto:david.scott@ftb.ca.gov)

Brian Putler  
Legislative Director, FTB  
(916) 845-6333  
[brian.putler@ftb.ca.gov](mailto:brian.putler@ftb.ca.gov)