ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Perea	Analyst:	David Scott	Bill Number:	AB 2045
Related Bills:	See Legislative History	Telephone:	845-5806	Amended Date:	April 9 & 16, 2012
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: NOL Deduction/Corporation Business Tax Benefit Transfer Certificate Program

SUMMARY

This bill would establish a program with the Treasurer to allow “new or expanding emerging technology and biotechnology companies” (NEETBC) to surrender and transfer their unused net operating losses (NOL) in exchange for financial assistance and allow corporate tax filers to acquire and use the surrendered NOLs by providing the financial assistance to the NEETBC.

RECOMMENDATION

No position.

Summary of Amendments

The bill, as introduced on February 23, 2012, made changes to the Health and Safety Code.

The April 9, 2012, and April 16, 2012, amendments removed all of the bill’s provisions, related to the Health and Safety Code, and replaced them with the provisions discussed in this analysis. This is the department’s first analysis of the bill. This analysis only addresses the provisions of this bill that impact the department’s programs and operations.

REASON FOR THE BILL

The reason for the bill appears to be to provide new and emerging technology and biotechnology companies in California with a means to use their NOLs to obtain financial assistance to continue to create innovation in California.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2013, and would apply to taxable years beginning on or after that date.

Board Position:			Executive Officer	Date
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ANALYSIS

FEDERAL/STATE LAW

FEDERAL LAW

Federal law generally defines an NOL as the excess of deductions allowed over the gross income.

When a taxpayer has an operating loss for a taxable year, the operating loss that may be deducted 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 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, 2013, 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 2013 is limited to 50 percent of the NOL.
3. The amount of NOL carryback attributable to taxable year 2014 is limited to 75 percent of the NOL.
4. The amount of NOL carryback attributable to taxable year 2015 and thereafter is 100 percent of the NOL.

Generally, no NOL deductions were allowed for taxable years 2008 through 2011. For taxable years 2008 and 2009, the deduction suspension did not apply to taxpayers with under $500,000 of net business income. For taxable years 2010 and 2011, the suspension did not apply to taxpayers with modified adjusted gross income under $300,000.

THIS BILL

This bill would do the following:

- Establish a program under the Treasurer's office for NEETBCs to surrender and transfer unused NOLs and receive financial assistance in return. The surrendered NOLs would become a corporation business tax benefit certificate (certificate).
- Allow corporate tax filers (acquirer) to acquire certificates for providing financial assistance to the NEETBC that surrendered the NOL.
- Set the minimum amount of financial assistance to obtain the certificate at 80 percent of the "surrendered tax net operating losses" (STNOLs).
- Define STNOL to mean the amount that is the product of the NOL times the anticipated apportionment factor for the year of transfer times the tax rate of the acquirer.
- Establish the following allocation process for the transfer of STNOL.
    - If the unused NOL of the NEETBC is $250,000 or less, the full amount would be allowed.
    - If the unused NOL of the NEETBC is greater than $250,000, the amount allowed would be the sum of:
        - The full amount of the first $250,000, and
        - The product of the amount in excess over $250,000 multiplied by a fraction with a numerator that would be the total amount the Treasurer is authorized to approve (maximum $60 million) less the total amount already approved, and a denominator that would be the total amount of NOL requested to be surrendered less the total amount approved.
- Establish the following criteria for NEETBCs to be able to surrender NOLs:
    - Must not show positive income on their Generally Accepted Accounting Principles (GAAP) financial statements in the two previous years.
    - Must not be owned 50 percent or controlled by another corporation with positive income on the group's GAAP financial statements for the previous two years.
    - Must not be part of a federal consolidated return group that shows positive income on their GAAP financial statements for the two previous years.
    - The NEETBC must certify that they will continue as a NEETBC and have no current intentions to cease operations.
- Establish a maximum lifetime limit of $15 million that a NEETBC can surrender under the program.
- Provide for rule making for the recapture of the NOL benefit if certain criteria is not met:
    - The NEETBC fails to use the financial assistance; or
    - The NEETBC fails to maintain a headquarters or base of operations in California, unless due to liquidation.
- The acquirer must apply to the Treasurer to acquire STNOLs. The Franchise Tax Board (FTB) would assist in reviewing the applications.
- Prevent the acquirer from using the certificates until the first day of the fourth year after the date the certificate is issued.
- Make the certificates invalid if the NEETBC is no longer in business or was not acquired on the first day of the fourth year after the certificate is issued.

- Provide definitions for biotechnology, biotechnology company, new or expanding, and technology company.

IMPLEMENTATION CONSIDERATIONS

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

- The bill fails to include provisions in the Revenue and Taxation Code (R&TC) in order to allow the use of corporation business tax benefit certificates to reduce the taxpayer's taxable income, as if it was an NOL generated by the taxpayer or to apply the amount of tax benefit against the taxpayer's tax liability (like a credit).
- The bill fails to provide guidance for the approval of acquirers, other than the acquirers must apply and enter into a written agreement to provide financial assistance to the NEETBC in exchange for the certificate. Under current law, if an acquirer acquires a target entity and does not merge the business into the acquirer, then the tax attributes (including NOLs) remain with the target entity and can only be used by the target entity, as it becomes profitable, to offset its taxable income. If the acquirer merges the target entity's business into the acquirer's business, then the tax attribute of the target (including the NOLs) become available for the acquirer to use to its offset current taxable income. It is unclear if the acquirer can request the certificates of a specific corporation or not. If the acquirer can request the specific NOLs of a potential target entity, then the acquirer is receiving the tax attributes (specifically the NOLs) on the front end for use in the fourth year without having to merge the entity into the acquirer's business. The language should clarify the process to: (1) allow the request for a specific company's NOL; (2) restrict the acquirer to purchasing a certificate for an amount of NOLs from a pool of NOLs; or (3) some other method that meets the author's intent.
- The bill provides for the surrender of NOLs generated under PIT law (individuals, partnerships and LLC's). Those NOLs become NOLs at the partner/member level. This could lead to some partners/members surrendering and some not surrendering their NOLs. This would be difficult to track and administer by FTB. A potential solution would be to limit the surrender to corporate NOLs only.
- The bill is silent on a number of issues, such as the deductibility of the acquisition costs or whether the NEETBC has income as a result of receiving the required financial assistance. These issues were addressed in the language for the assignments of credits within a combined reporting group and would need to be included in the language of the bill in order for FTB to administer the bill.
- At the time of surrendering its NOL, most taxpayers will not have had their NOL audited by the FTB. As a result, when the NOL is audited, most likely several years later, the audit findings could affect the allocation of the $60 million cap on transferred NOLs for that tax year. Technically, FTB would have to re-evaluate the calculation and provide the revised information to the Treasurer. This would complicate the administration of the allocation cap as the allocated amount would fluctuate as audit cycles are completed. An allocation process similar to the allocation process for the movie credit (first in line approach) could be a more effective method.

TECHNICAL CONSIDERATIONS

The bill includes a definition for the unused term “transferable tax benefits.” This section should be deleted, unless the intent is that the $60 million limitation would apply to transferable tax benefits, versus NOLs surrendered.

LEGISLATIVE HISTORY

AB 1147 (Mullin, 2007/2008) would have allowed certain corporations to sell their unused NOLs. The bill failed to pass out of the Assembly Revenue and Taxation Committee.

OTHER STATES’ INFORMATION

This bill is patterned after the *New Jersey* corporation business tax benefit certificate transfer program. The *New Jersey* program allows new or expanding emerging technology and biotechnology companies in *New Jersey* to surrender their unused NOLs for financial assistance equal to 75 percent of the tax benefit. The tax benefit is computed by multiplying the NOL surrendered by the allocation factor times the tax rate. It is the tax benefit that becomes the certificate, not the amount of the NOL. The *New Jersey* cap is on the tax benefit, not on the amount of NOLs transferred. The certificate is applied like a tax credit to the acquirer’s tax liability. The *New Jersey* test for affiliation is much stricter. If direct or indirect control of voting rights for both the acquirer and the company surrendering the NOLs is equal to or exceeds 5 percent, the transfer cannot take place.

FISCAL IMPACT

The bill would require the FTB to work in cooperation with the Treasurer in reviewing the applications of the NEETBCs, as well as the applications of the acquirers. This would create a new workload for the department. As a result, this bill could impact the department’s personnel and other costs. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 2045
For Taxable Years Beginning On Or After January 1, 2013
Assumed Enactment After June 30, 2012
($ in Millions)

2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
-$0.02	-$0.06	-$0.04	-$0.02	-$2.40	-$5.00	-$5.40

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

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: The bill provides a means for new and emerging creators of innovation in California to receive financial assistance to continue to pursue innovation in California.

Opponents: This bill is unnecessary because creators of quality innovative ideas don't need financial assistance because they would be pursued by large corporations to acquire their products.

POLICY CONCERNS

The lack of clarity on whether an acquirer can request and receive the certificate of a specific NEETBC could lead to the possibility of an acquirer obtaining the certificate of an acquisition target and being able to use the NOLS of the target, then make the acquisition. Currently, when a target entity is acquired the NOLs of that entity remain with the target and cannot be used by the acquiring entity.

LEGISLATIVE STAFF CONTACT

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