Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Donnelly and Grove	Analyst:	Diane Deatherage	Bill Number:	AB 1651
Related Bills:	None	Telephone:	845-4783	Introduced Date:	February 11, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Tangible Personal Property Fair Market Value Loss Deduction

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), allow a deduction for the loss of the fair market value (FMV) in tangible personal property attributable to the enactment of a statute, administrative rule or regulation.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to provide relief to those who lose value on private owned property due to a new regulation or law.

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, 2014.

ANALYSIS

FEDERAL/STATE LAW

Under existing federal and state law taxpayers may deduct losses related to tangible personal property as either:

- Casualty, disaster, or theft loss.
- Depreciation.

Board Position:			Executive Officer	Date
____ S	____ NA	X NP		
____ SA	____ O	____ NAR	Selvi Stanislaus	03/19/14
____ N	____ OUA			

Casualty, disaster, and theft loss

A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual:

- A sudden event is one that is swift, not gradual or progressive.
- An unexpected event is one that is ordinarily unanticipated and unintended.
- An unusual event is one that is not a day-to-day occurrence and that is not typical of the activity in which a taxpayer was engaged.

Deductible casualty losses can result from a number of different causes, including the following:

- Earthquakes.
- Fires.
- Floods.
- Government-ordered demolition or relocation of a home that is unsafe to use because of a disaster.
- Mine cave-ins.
- Shipwrecks.
- Sonic booms.
- Storms, including hurricanes and tornadoes.
- Terrorist attacks.
- Vandalism.
- Volcanic eruptions.

Generally, casualty losses are deductible during the taxable year that the loss occurred.

Under California and federal law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Under federal and state tax law, the taxpayer may elect to claim the disaster loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made prior to passage of any state legislation allowing special carryover treatment because California conforms to the federal election.

A theft is the taking and removing of money or property with the intent to deprive the owner of it. The taking of property must be illegal under the law of the state where it occurred and it must have been done with criminal intent.

Theft includes the taking of money or property by the following means:

- Blackmail.
- Burglary.
- Embezzlement.
- Extortion.
- Kidnapping for ransom.
- Larceny.
- Robbery.

The taking of money or property through fraud or misrepresentation is theft if it is illegal under state or local law.

Generally, theft losses are deductible in the taxable year in which the theft was discovered.

Nonbusiness disaster losses not reimbursed by insurance or otherwise are deductible under state and federal tax law to the extent each loss exceeds $100. Total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10 percent of adjusted gross income.

California law provides for specific carryforward treatment for disaster losses. That is, 100 percent of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, 50 percent of the remaining excess loss may be carried over for up to 10 additional years.

Depreciation

Existing federal and state laws generally allow a deprecation deduction for the obsolescence or wear and tear of property used in the production of income or property used in a trade or business. The amount of this deduction is determined, in part, by the cost (or basis) of the property. In addition, the property must have a limited, useful life of more than one year.

Obsolescence may render an asset economically useless to a taxpayer regardless of its physical condition. Obsolescence may be attributable to a number of causes, including technological improvements, reasonable foreseeable economic changes and legislative or regulatory action that prohibits or otherwise limits use of the property for its intended purpose. For example, property that would be unable to meet the requirements of new air quality regulations could be rendered obsolete prior to the end of its estimated useful life. When property becomes obsolete, the property's estimated useful life would be revised and the remaining basis would be deducted over the revised useful life. In the case of property with no remaining useful life, 100 percent of the remaining basis would be deductible in the year of obsolescence.

THIS BILL

This bill would allow a deduction under the PITL and the CTL for the loss in the FMV of tangible personal property attributable to a rule or regulation promulgated by a California state agency or statute enacted by the California Legislature that took effect in the taxable year in which the deduction is claimed.

IMPLEMENTATION CONSIDERATIONS

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill lacks administrative details necessary to implement the bill and determine its impacts to the department's systems, forms, and processes. The bill is silent on the following issues:

- When and by whom would a decrease in FMV be determined and verified? Would an appraisal be required? Would an appraisal require certain components or characteristics?
- What would happen if the FMV increased after the taxpayer deducted the loss in FMV in a previous year? Should there be a recapture provision?
- Would the asset's basis be reduced by the loss deducted? Could the loss deducted exceed the asset's basis?
- What if a rule or regulation promulgated by a California state agency or statute enacted by the California Legislature resulted in an increase in the FMV of tangible personal property?
- Would a taxpayer be allowed to claim the deduction on property that is located or used outside of the state?
- Would this bill create a new deduction that would allow a taxpayer to report a loss that they are not already entitled to utilize or would existing law suffice?
- Would this deduction be in addition to the existing depreciation deduction, thus, allowing a taxpayer a double benefit?

The bill lacks a definition or reference to a definition of "fair market value." There are specific definitions for fair market value contained in the income tax laws of the Revenue and Taxation Code (R&TC) as well as the Internal Revenue Code. The author may want to consider referencing one of these definitions. Use of an existing definition would reduce possible confusion for the taxpayer and the department.

This bill uses phrases that are undefined, i.e., "tangible personal property" and "rule or regulation promulgated by a California state agency or statute enacted by the California Legislature." The absence of definitions to clarify these phrases could lead to disputes with taxpayers and would complicate the administration of this deduction.

OTHER STATES' INFORMATION

Review of *Florida, Illinois, Massachusetts, Michigan*, *Minnesota*, and *New York* laws found no comparable deduction for a decrease in FMV. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida only has a corporation income tax therefore this personal income tax deduction is not applicable.

FISCAL IMPACT

The department's costs to administer this bill are unable to be determined until implementation concerns have been resolved. 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

To determine the potential impact of this proposal to the General Fund would require predicting the frequency, number and nature of future statutes, rules, or regulations. It would also require knowledge of the tangible personal property impacted, including the value before and after the loss, as well as the income characteristics of qualified taxpayers using the deduction. Because it is impractical to predict these future events, the revenue impact to the General Fund is undeterminable.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Supporters could argue that a deduction for the decrease in the FMV of tangible personal property is appropriate relief when state regulatory or legislative action is the cause of the decrease.

Opponents: Some could argue that existing depreciation deduction law provides appropriate relief that more accurately reflects the decline in value of a taxpayer’s tangible personal property due to state regulatory or statutory action.

POLICY CONCERNS

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

LEGISLATIVE STAFF CONTACT

Diane Deatherage	Mandy Hayes	Jahna Carlson
Legislative Analyst, FTB	Revenue Manager, FTB	Asst. Legislative Director, FTB
(916) 845-4783	(916) 845-5125	(916) 845-5683
diane.deatherage@ftb.ca.gov	mandy.hayes@ftb.ca.gov	jahna.carlson@ftb.ca.gov