SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author:	Harkey	Analyst:	Diane Deatherage	Bill Number:	AB 1984
Related Bills:	See Legislative History	Telephone:	845-4783	Amended Date:	May 1, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Net Operating Loss Deduction Carryback Conformity with Modifications

SUMMARY

This bill would provide modified state conformity to federal net operating loss (NOL) carryback procedures under the Administration of Franchise and Income Tax Laws (AFITL).

RECOMMENDATION

No position.

Summary of Amendments

The May 1, 2014, amendments modified the tentative carryback and refund adjustment, interest, and overpayment provisions applicable to California NOL carrybacks and removed a provision that would have required the Franchise Tax Board (FTB) to prescribe regulations providing for the crediting against the estimated tax of the amount determined to be an overpayment of tax for a preceding taxable year.

As a result of these amendments, all of the technical considerations, as provided in the department's analysis of the bill as amended April 1, 2014, have been resolved, and two new technical considerations were identified. Except for the "This Bill," "Technical Considerations," and "Economic Impact" sections, the remainder of the department's analysis of the bill as amended April 1, 2014, still applies. The "Federal/State Law" and "Fiscal Impact" sections are restated for convenience.

Summary of Suggested Amendments

Amendment language is provided under the Technical Considerations sections that would correct references within the language of the bill.

ANALYSIS

<u>FEDERAL LAW</u>

Net Operating Loss Law

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

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When a taxpayer has an operating loss for a taxable year, the operating loss that may be deducted in another year 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 two 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 could elect to increase the NOL carryback period for an applicable 2008 or 2009 NOL from two years to three, four, or five years.

Federal law modifies some of the provisions for the payment of interest and the statute of limitations for assessing additional tax when taxpayers take advantage of NOL carrybacks. In addition, federal law modifies the statute of limitations for assessing additional tax, and the provision for payment of interest on refunds applicable to NOL carrybacks.

Internal Revenue Code (IRC) Section 6164

Under federal law, a corporation that expects an NOL in the current tax year may file to extend the time for payment of tax for the immediately preceding tax year. This includes extending the time for payment of a tax deficiency. The payment of tax that can be postponed cannot exceed the expected overpayment from the carryback of the NOL.

In general, the extension for paying the tax expires at the end of the month in which the return for the tax year of the expected NOL is required to be filed, including extensions.

IRC Section 6411

Also, federal law provides for an expedited refund for NOL carrybacks by allowing taxpayers to file an application for tentative refund resulting from:

- The carryback of an NOL,
- The carryback of a net capital loss,
- The carryback of an unused general business credit,
- The carryback of a net contracts loss, or
- An overpayment of tax due to a claim of right adjustment.

The application for tentative refund must be filed no later than 12 months of the end of the tax year in which an NOL, net capital loss, unused credit, net contracts loss, or claim of right adjustment arose.

Within a period of 90 days from the date on which an application for a tentative carryback adjustment is filed, the Internal Revenue Service (IRS) must perform a limited examination of the application to discover omissions and errors of computation. The IRS may disallow the application if there are any material omissions or any errors of computation that are not corrected within the 90-day period.

STATE LAW

Net Operating Loss Law

In general, a California taxpayer calculates its NOL in accordance with federal rules. NOLs attributable to taxable years beginning on or after January 1, 2008, may be carried forward 20 years. For NOLs attributable to taxable years beginning before January 1, 2013, NOL carrybacks are unavailable. California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2013, with modifications.

California law provides that losses generated in taxable years beginning January 1, 2013, and later will be allowed to be carried back to the two preceding tax years. No losses may be carried back to years beginning before January 1, 2011.

The new carryback is phased in as follows:

- The law provides that 50 percent of the NOL generated in taxable years beginning in 2013 is eligible for a two year carryback.
- 75 percent of the NOL generated in taxable years beginning in 2014 is eligible for a two year carryback. Any excess that is not carried back may be carried forward.
- 100 percent of the NOL generated in taxable years beginning in 2015 is eligible for a two year carryback.

For a calendar year taxpayer, this means that a $10,000 loss generated in 2013 will be treated as follows:

- Up to 50 percent of the loss ($10,000 x 50% = $5,000) can be carried back to 2011 and 2012.
    - For example if $4,000 of the loss can be used in 2011, the remaining $1,000 could be carried to 2012.
- Any portion of that remaining $1,000 not used in 2012 (and the $5,000 not carried back at all) will be allowed to be carried forward to 2014 and later years.

For a calendar year taxpayer, this means that an $8,000 loss generated in 2014 will be treated as follows:

- Up to 75 percent of the loss ($8,000 x 75% = $6,000) can be carried back to 2012 and 2013.
    - For example if $4,000 of the loss can be used in 2012, the remaining $2,000 could be carried to 2013.
- Any portion of that remaining $2,000 not used in 2013 (and the $2,000 not carried back at all) will be allowed to be carried forward to 2015 and later years.

Generally for corporate taxpayers, NOL deductions were suspended for taxable years 2008 through 2011. For taxable years 2010 and 2011, the suspension applied to taxpayers with pre-apportioned income of $300,000 or more.

The NOL carryback provisions disregard the NOL suspension period and allow taxpayers to carryback an NOL, from a taxable year beginning on or after January 1, 2013, two years to a taxable year beginning on or after January 1, 2011.

California does not modify its rules for interest computations or statute of limitations relating to NOL carrybacks.

THIS BILL

This bill would conform with modifications, to the federal provisions that allow a taxpayer with NOL carrybacks to obtain a tentative refund of taxes paid in prior tax years by filing a tentative carryback adjustment application (see the IRC section 6411 under the Federal Law section above) and allow a corporation to apply to extend the time for payment of taxes for the immediately preceding taxable year (see the IRC section 6164 under the Federal Law section above).

Modifications

- The FTB would have 180 days from the date on which an application for a tentative carryback adjustment is filed, to perform a limited examination of the application to discover omissions and errors of computation and could disallow the application if there are any material omissions or any errors of computation that are not corrected within the 180-day period. The federal period is 90 days.

- A taxpayer may file an application for a tentative carryback adjustment for a California NOL attributable to the 2013 taxable year on the date that is the later of:
    - 6 months after the effective date of the act adding the tentative carryback provisions, OR
    - 12 months after the end of the taxpayer's 2013 taxable year.

This bill would conform to the federal provisions modifying the general statute of limitations period when a taxpayer carries back a California NOL and would allow:

- Claims for refund based on a California NOL carryback to be filed within the statute of limitations of the return for the taxable year in which the NOL was created, plus the period granted for any extension of time to file for the year in which the NOL was created.

- The FTB to assess a deficiency attributable to a California NOL carryback deduction before the expiration of the assessment limitation period for the taxable year in which the NOL was created.

Claims for refund of an overpayment resulting from the carryback of a California NOL with respect to a taxable year that a tentative carryback adjustment application is subsequently filed would be treated as having been filed on the date that the application was filed.

Similar to federal treatment, for purposes of calculating interest, an overpayment of tax resulting from a California NOL carryback would not be deemed to have been made before the filing date for the taxable year in which that NOL carryback arises. Filing date would mean the last date for filing the return for that taxable year without regard to extensions.

The FTB would be allowed to assess amounts applied, credited, or refunded based on a tentative carryback adjustment application determined to be in excess of the overpayment attributable to the carryback as an overstatement of a credit.

TECHNICAL CONSIDERATIONS

On page 7, line 9, "Section 19001" should be changed to "Section 17001" to reflect the correct commencing section of Part 10.

On page 7, line 30, "of paragraph (2)" should be inserted after subparagraph (A) for a more accurate reference.

FISCAL IMPACT

This bill would significantly impact the department's printing, processing, and programming 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 1984* As Amended May 1, 2014 Enactment Assumed After June 30, 2014 ($ in Millions)			
2014-15	2015-16	2016-17	2017-18
- $90	- $105	- $150	- $90

*The revenue impact of this bill is primarily a shift in the timing of payments, not a permanent change in revenue.

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

SUPPORT/OPPOSITION

Support: California Taxpayers Association (Sponsor), California Chamber of Commerce, California Manufacturers & Technology Association, and National Federation of Independent Businesses.[1]

Opposition: None provided.

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[1] From the Assembly Revenue and Taxation Committee analyses, dated 04/18/14 and 04/25/14.