Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Wieckowski	Analyst:	Brian Werking	Bill Number:	AB 458
Related Bills:	See Legislative History	Telephone:	845-5103	Introduced Date:	February 19, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Business Expense Deduction/Disallow Deduction for Punitive Damages Beginning January 1, 2014

SUMMARY

This bill would repeal the income or franchise tax deduction related to punitive damages.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to eliminate the tax benefit allowed to taxpayers that are subject to punitive damage awards for wrongdoing 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, 2014.

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 or 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 deductable as ordinary and necessary expenses.

Board Position:			Executive Officer	Date
_______ S	_______ NA	___X___ NP		
_______ SA	_______ O	_______ NAR	Selvi Stanislaus	03/20/13
_______ N	_______ OUA			

THIS BILL

This bill would repeal the deductability of punitive damages paid or incurred in connection with any judgment in, or settlement of, any action.

IMPLEMENTATION CONSIDERATIONS

This bill uses the undefined term, "punitive damages." The absence of a definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill.

LEGISLATIVE HISTORY

AB 1276 (Feuer, 2011/2012) was identical to this bill and would have disallowed the deduction of punitive damages paid or incurred in connection with any judgment in, or settlement of, any action. AB 1276 failed to receive the required 2/3rds vote to move out of the Assembly.

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 458 For Taxable Years Beginning On or After January 1, 2014 Enactment Assumed After June 30, 2013		
2013-14	2014-15	2015-16
+$400,000	+$1,000,000	+$1,100,000

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: Proponents may argue that eliminating the deductability of punitive damages would eliminate a tax benefit that reduces the incentive to change behavior found to be unacceptable.

Opponents: Opponents may argue that eliminating the deductability of punitive damages would increase taxes on businesses, as well as the net costs of litigation, burdening the economy and increasing the costs of goods and services to the average consumer.

LEGISLATIVE STAFF CONTACT

Brian Werking	Mandy Hayes	Gail Hall
Legislative Analyst, FTB	Revenue Manager, FTB	Legislative Director, FTB
(916) 845-5103	(916) 845-5125	(916) 845-6333
brian.werking@ftb.ca.gov	mandy.hayes@ftb.ca.gov	gail.hall@ftb.ca.gov