ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Skinner	Analyst:	David Scott	Bill Number:	AB 769
Related Bills:	See Legislative History	Telephone:	845-5806	Introduced Date:	February 21, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Net Operating Loss Deduction/Disallow Carryback

SUMMARY

This bill would eliminate the two-year carryback of net operating losses (NOLs), so that NOLs could only be carried forward.

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for this bill is to eliminate the NOL carryback provisions because in the current economic situation the State cannot afford NOL carrybacks and these carrybacks are particularly disruptive to the State's ability to budget, and when California's most profitable companies pay less tax, the public has to pay more.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2013.

ANALYSIS

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 could elect to increase the NOL carryback period for an applicable 2008 or 2009 NOL from 2 years to 3, 4, or 5 years.

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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. See Exhibit A (attached) for more details.

STATE 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 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 an NOL carryback attributable to taxable year 2013 is limited to 50 percent of the NOL.
3. The amount of an NOL carryback attributable to taxable year 2014 is limited to 75 percent of the NOL.
4. The amount of an NOL carryback attributable to taxable year 2015 and thereafter is 100 percent of the NOL.

Generally for taxpayers subject to the Personal Income Tax Law (PITL), NOL deductions were suspended for taxable years 2008 through 2011. For taxable years 2010 and 2011, the suspension applied to taxpayers with modified adjusted gross income of $300,000 or more.

Generally for Corporation Tax Law (CTL) 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, in the PITL and CTL, disregard the NOL suspension period and allow taxpayers to carryback a net operating loss, from a taxable year beginning on or after January 1, 2013, two years to a taxable beginning on or after January 1, 2011.

California does not modify its rules for interest computations or SOLs relating to NOL carrybacks. See Exhibit A (attached) for more details.

THIS BILL

This bill would remove the language in the PITL[1] and the CTL[2] that allows taxpayers to carry back an NOL to the two previous taxable years and offset income from those years.

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[1] Part 10 (commencing with Section 17001) of Division 2 of the Revenue and Taxation Code.
[2] Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department’s programs and operations.

LEGISLATIVE HISTORY

AB 2408 (Skinner, 2011/2012), a substantially similar bill, would have disallowed the use of net operating loss carrybacks by individuals and corporate taxpayers. AB 2408 failed to pass out of the Senate by the constitutional deadline.

AB 1936 (DeLeon, 2009/2010) would have disallowed the use of NOL carrybacks by individual and corporate taxpayers. AB 1936 passed from the Assembly Appropriations Committee without further action.

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.

Florida generally follows federal NOL rules.

Illinois does not conform to federal NOL rules. For corporations, partnerships, and S corporations filing in *Illinois,* there was no NOL deduction allowed for 2010-2012. No carryover deduction can exceed $100,000 for any taxable year ending on or after December 31, 2012, and prior to December 31, 2014. Any excess may be carried forward for up to 12 years.

New York generally follows federal NOL rules, but limits the amount of the NOL carryback to $10,000. The balance of the NOL may be carried forward for up to 20 years.

Michigan and *Minnesota* allow an NOL to be carried back for 2 years and forward for up to 20 years.

Massachusetts does not allow an NOL carryback and allows a five-year carry forward.

FISCAL IMPACT

Implementing this bill would not significantly impact the department’s programs and operations.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 769 Introduced on February 21, 2013 For Taxable Years Beginning On or After January 1, 2013 Assumed Enactment After June 30, 2013 ($ in Millions)		
2013-14	2014-15	2015-16
+$5	+$75	+$70

This estimate 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: Some may say that allowing NOL carrybacks during prior year budget negotiations was a permanent give-away in exchange for a temporary stream of revenue that California cannot afford in light of its budget issues.

Opponents: Some may say that California's continual changes to the Revenue and Taxation Code make it difficult for taxpayers to tax plan.

LEGISLATIVE STAFF CONTACT

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Exhibit A

Federal Law

Underpayments[3]

Generally, an underpayment of taxes occurs when a taxpayer's tax liability for a taxable year is greater than the payments made by the taxpayer to cover their tax liability. An underpayment can occur for a variety of reasons including when a taxpayer amends a previously filed return to report additional income, to decrease deductions or to decrease tax credits for that year. The net effect of any of these is that more tax is owed for the previously filed tax year.

If there is an underpayment, interest is charged to taxpayers under specific rules. If any amount of tax is not paid by the last day for payment resulting in an underpayment, without regard for extensions to pay or installment agreements entered into by the taxpayer, interest will be calculated on the amount of the underpayment beginning from the last day for payment. The last day for payment is the date the tax liability arises and is generally the original due date of the tax return, but will not be later than the date the Secretary of the Treasury issues a notice and demand for the tax. The current interest rate charged for an underpayment is four percent.

Overpayments[4]

Generally, an overpayment of taxes occurs when a taxpayer has paid more than the amount of their tax liability. An overpayment can occur as the result of amending a previously filed return to report a decrease in the amount of taxable income or an increase to allowed deductions or credits. The net effect of any of these is that less tax is owed for the previously filed tax year, and the taxpayer is entitled to a refund.

Interest is paid on overpayments under specific rules. If an overpayment is from the carryback of an NOL, the overpayment is deemed to arise on the filing date of the original return for the taxable year from which the NOL arose. Filing date means the later of the date the return was filed or the original due date without taking into account extensions.

Interest allowed on an overpayment is calculated at an established rate.[5] The current interest rate paid for an overpayment is four percent for non-corporate taxpayers and three percent for corporate taxpayers. Interest is calculated from the date of overpayment to the date paid, less time to process the check or other form of payment. The time to process the payment could be up to 30 days.

If a taxpayer files a claim for refund and the refund is paid within 45 days of the date filed, no interest will be paid on the refund amount.

[3] IRC section 6601.
[4] IRC section 6611.
[5] IRC section 6621.

When a taxpayer generates an NOL in a current taxable year, for which the return is being filed, and carries that NOL back and applies it to a previously filed return with an open statute, the statute of limitations (SOL) to assess additional tax for the previously filed taxable year is extended to the last date to assess additional tax for the taxable year that generated the NOL. For example, a taxpayer generates an NOL in taxable year 2012 and files the return on April 15, 2013. The SOL for the 2012 return would be April 15, 2016. The taxpayer then amends the 2010 taxable year return on April 16, 2013, carrying back that 2012 net operating loss and reducing the 2010 net income. The 2010 taxable year return was originally filed on April 15, 2011. The normal SOL would be April 15, 2014, three years from the original due date, in this case. Because the taxpayer applied the 2012 NOL to the 2010 net income, the SOL for the 2010 taxable year is extended to April 15, 2016.

California Law[6]

Current California law provides that interest is charged on underpayments of tax from the last day prescribed for payment to the date the payment is made. The last day prescribed for payment is the date the tax liability arises, not later than the date notice and demand is made by the Franchise Tax Board. This generally is the due date of the tax return, without regard for extensions to file.

Current California law also provides that interest is paid on overpayments of tax from the date of the overpayment to the date paid, less time to process the check or other form of payment. The time to process the payment could be up to 30 days. Unlike federal law, California has no interest rules specific to NOL carrybacks. Accordingly, the general rule for payment of interest would be applied. That rule is that overpayment interest is generally paid from the original due date of the return, regardless of when the claim for refund is filed. Interest is not paid if a refund is made to a corporation within 90 days from the date the return is filed or to an individual within 45 days of the date the return is filed, or for periods before a return is filed if the return was filed after the extended due date. There are no special rules for overpayments resulting from the carry back of an NOL. As a result, a taxpayer filing an amended return to deduct an NOL carryback will receive interest from the date of the original payment.

At the time California put the NOL carryback rules into the Revenue and Taxation Code, California did not adopt the special SOL rules that the IRS has for when an NOL carryback is used to amend a prior year income or franchise tax return, as discussed above.

[6] RT&C sections 18007 – 18009, 19101, 19340, and 19521.