Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Bocanegra	Analyst:	David Scott	Bill Number:	AB 879
Related Bills:	See Prior Analysis	Telephone:	845-5806	Amended Date:	April 16, 2013
		Attorney:	Patrick Kusiak	Sponsor:	

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

SUMMARY

This bill would establish a corporate business tax benefit certificate program that would allow a qualified transferor to surrender unused net operating losses (NOLs) to a qualified transferee in exchange for cash payments.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The April 16, 2013, amendments made various changes including, modifying the operative period for the program, requiring the transferee to provide cash payments instead of private financial assistance, plus a number of changes to the program procedures. The amendments also resolved several of the department's implementation considerations regarding private financial assistance, and one of the department's technical considerations.

Except for the "Effective/Operative Date" and "This Bill" sections, the department's analysis of the bill as introduced February 22, 2013, still applies. The "Fiscal Impact", "Economic Impact", and the remaining implementation and technical considerations are provided for convenience.

EFFECTIVE/OPERATIVE DATE

This bill would become effective on January 1, 2014, and operative for taxable years beginning on or after January 1, 2014 and before January 1, 2019.

Board Position:			Legislative Director	Date
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ANALYSIS

THIS BILL

This bill would do the following, for taxable years beginning on or after January 1, 2014 and before January 1, 2019:

- Establish a corporation business tax benefit certification transfer program under the Treasurer's office for new and expanding emerging technology and biotechnology companies (Emerging Companies) (transferors) that are subject to the corporate income or franchise tax, to surrender unused NOLs and receive cash payments in return. The surrendered NOLs would become a corporation business tax benefit certificate (certificate).
- Allow corporate tax filers (transferees) to acquire certificates for providing cash payments to Emerging Companies that surrender an NOL.
- Set the minimum amount of cash payment to obtain the certificate at 80 percent of the amount of the "surrendered tax net operating losses" (surrendered losses).
- Define the tax benefit of the surrendered losses to mean the amount that is the product of the face value of the surrendered loss amount times the tax rate of the qualified transferee as of the date transferred.
- Establish the following allocation process for the transfer of surrendered loss:
    - The Treasurer shall set aside at least $25 million, of the total $60 million to be allocated per fiscal year, for small qualified transferors, defined as having less than $250,000 of available unused NOLs for transfer.
    - The remaining amount shall be allocated on a first-come first-served basis.
    - If applications for transfer exceed $60 million, the excess shall be deemed applied for in the next fiscal year.
- Define the following terms: acquire, biotechnology, biotechnology company, full-time employee, group health plan, new or expanding, qualified transferee, qualified transferor, related person, small qualified transferor, and technology company.
- Establish the following criteria that Emerging Companies would be required to meet on both (1) the date its application is submitted and (2) the date its certificate is received, to be able to surrender NOLs:
    - Must not show positive net operating income on their Generally Accepted Accounting Principles (GAAP) financial statements in the two previous taxable years.
    - Must not be owned 50 percent or controlled by another corporation:
        - With positive net operating income on the group's GAAP financial statements for the previous two years.
        - That is part of a federal consolidated return group that shows positive net operating income on their GAAP financial statements for the two previous years.

- Must have fewer than 225 employees in the US and:
  - If incorporated for less than three years, has at least one full-time employee working in this state, or
  - If incorporated for more than three years but less than five years, at least five full-time employees in this state, or
  - If incorporated for more than five years, at least 10 full-time employees working in this state.
- The Emerging Company must certify that they will continue as an Emerging Company and have no current intentions to cease operations.

- Establish a maximum lifetime limit of $15 million that an Emerging Company can surrender under the program.
- Allow the Treasurer to establish rules specific to the recapture of the NOL benefit if the Emerging Company fails to use the cash payment provided by the transferee as required.
- Require that the transferee apply to the Treasurer to acquire surrendered losses after January 1 and on or before June 30 of each year. The Franchise Tax Board (FTB) would assist in reviewing the applications.
- Require the Treasurer, with the cooperation of the FTB, to certify the amount of surrendered NOLs that a transferor is allowed to transfer.
- Require the Treasurer to issue the transfer certificate on or before November 1.
- Prevent the transferee claiming the NOL amounts on the certificates until the first day of the fourth year after the date the certificate is issued.
- Exclude banks and financial corporations from being a transferee.
- Provide rules to limit churning of NOLs by companies becoming new entities when they reach the $15 million maximum lifetime limit for surrendering NOLs.
- Prevent the resale of acquired NOLs by a transferee.
- Treat the qualified transferor as if it originally generated the NOL received, so that the transferee "stands in the shoes" of the transferor with respect to any limitations on the transferred NOLs.
- Exclude the transferee from carrying back the acquired NOLs.
- Hold the transferee and the transferor jointly and severally liable for any disallowance of any NOL surrendered and transferred.

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.

This bill uses the undefined terms and phrases, “consideration,” “emerging company,” and “unused but otherwise allowable net operating losses.” The absence of a definition to clarify these phrases could lead to disputes with taxpayers and would complicate the administration of this program.

The definition of “new or expanding” omits companies that have been incorporated exactly three years and exactly five years. It is recommended that the author amend the definition to include those employers incorporated exactly three and exactly five years by changing the specified length of incorporation. For example, to include the exactly three years, the author may wish to change the period of incorporation to “at least three years but less than five years”, and for the exactly five years, the author may wish to change the period of incorporation to “five years or more”.

<u>TECHNICAL CONSIDERATIONS</u>

- On page 4, the definition of “qualified transferor” excluded banks and financials, but did so only indirectly. The author may wish to specifically exclude corporations subject to tax under Section 23181.
- On page 4, in the definition of “new or expanding”, the term “working in this state” is included in two of the three requirements for employees in California, depending on the length of time the corporation has been incorporated. The author may wish to add “working” after “employees” on line 17, to make the requirements consistent.
- Paragraph (6) of subdivision (e) needs to be amended where the phrase "employees in the state” appears, as it should be "employees working in the state” for consistency within the paragraph.
- The definition of “qualified transferor” needs to be amended where the phrase “new or expanding emerging” appears as it should be “new or expanding” to correspond with the definition in paragraph (6) of subdivision (e).

<u>FISCAL IMPACT</u>

This bill would require system changes to certify the amount of the NOLs to be transferred, to monitor and track the transfer and use of the NOLs, as well as changes to current forms. As a result, this bill would impact the department’s printing, processing, and storage costs. The additional costs will be developed as the bill moves through the legislative process.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of AB 879 As Amended April 16, 2013 For Taxable Years Beginning On or After January 1, 2014 Assumed Enactment After June 30, 2013 ($ in Millions)				
2014-17	2017-18	2018-19	2019-20	2020-21
0	- $1.8	- $4.6	- $5.1	- $5.1

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

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