Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Authors:	Anderson & Wyland	Analyst:	Scott McFarlane	Bill Number:	SB 797
Related Bills:	See Prior Analysis	Telephone:	845-5806	Amended Date:	January 6, 2014
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Net Operating Loss Deduction/Fraudulent Investment Arrangement Losses

SUMMARY

This bill would modify the Personal Income Tax Law and the Corporation Tax Law to match the federal income tax treatment of losses incurred by victims of fraudulent investment arrangements.

RECOMMENDATION

No position.

Summary of Amendments

The January 6, 2014, amendments would add a coauthor and would make minor technical changes.

As a result of the amendments, additional technical changes are suggested below under "Technical Considerations," and the "Economic Impact" section has been modified to assume that this bill would be enacted after June 30, 2014. Additionally, the "Support/Opposition" section has been updated. Other than those revised sections, the remainder of the department's prior analysis of this bill as amended April 1, 2013, still applies, and the "Effective Date," "Federal/State Law," and "This Bill" sections from that prior analysis are restated for convenience.

Summary of Suggested Amendments

Amendments 1 through 10 would resolve the technical concerns regarding Internal Revenue Code (IRC) "relating to" language.

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, 2008.

Board Position:			Asst. Legislative Director	Date
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ANALYSIS

FEDERAL/STATE LAW

On March 17, 2009, in response to the losses resulting from the collapse of Bernard Madoff's decades-long Ponzi scheme, the IRS issued Revenue Ruling 2009-9 and Revenue Procedure 2009-20 to provide guidance to taxpayers who are victims of fraudulent investment schemes.

Revenue Ruling 2009-9 clarifies the income tax law governing the treatment of losses from such schemes, including the nature of such losses (theft losses), the amount of such losses to be allowed, and the year of deductibility. Revenue Procedure 2009-20 simplifies compliance procedures for taxpayers by providing an optional safe-harbor means of determining the year in which the losses are deemed to occur, and a simplified method of computing the amount of the loss.

Federal and state laws are generally the same with respect to the deduction of theft losses. In general, where state law is in substantial conformity with the IRC, federal regulations, rulings and procedures are applicable for state purposes. Accordingly, Revenue Ruling 2009-9 and Revenue Procedure 2009-20 are applicable for state purposes to the extent federal and state laws are the same.

For purposes of applying the aforementioned revenue ruling and revenue procedure, where the statutes of limitations for filing a claim for refund are different for federal and state purposes, the state statute of limitations will control.

A taxpayer that takes advantage of the safe harbor for federal purposes is not required to do so for state purposes.

FEDERAL LAW

When a taxpayer has an operating loss for the taxable year, the operating loss that may be used in other years is called a net operating loss (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 that allow a 3-year period for the carryback of NOLs relating to casualty or theft losses.

Recent changes in federal law extend the carryback period up to five years for specified losses as described below.

The American Recovery and Reinvestment Act of 2009 allows certain taxpayers to make an irrevocable election to carry back applicable 2008 losses for up to 5 years (the normal carryback period is 2 years). The "applicable 2008 losses" are losses incurred in one taxable year that either begins or ends in 2008 by eligible small businesses (those whose average gross receipts are equal to or less than $15 million over a three-year period).

The Worker, Homeownership, and Business Assistance Act of 2009 allows taxpayers, other than taxpayers that received benefits under the Troubled Asset Relief Program, with business losses to make an irrevocable election to carry back losses incurred in one year (ending after 2007 and beginning before 2010) for up to 5 years.

Because Revenue Ruling 2009-9 defines losses on fraudulent investment schemes as businesses losses, an NOL resulting from a fraudulent investment loss is eligible for the extended NOL carryback period.

STATE LAW

In general, a California taxpayer calculates its NOL in accordance with federal rules. For NOLs attributable to taxable years beginning before January 1, 2013, NOL carrybacks are disallowed. NOLs attributable to taxable years beginning on or after January 1, 2008, may be carried forward 20 years. 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.
2. The amount of NOL carryback attributable to taxable year 2013 is limited to 50 percent of the NOL.
3. The amount of NOL carryback attributable to taxable year 2014 is limited to 75 percent of the NOL.

Current state law conforms to the federal carryback period for a Real Estate Investment Trust (REIT) and a corporate equity reduction interest loss, which is zero.

NOL deductions are suspended for taxable years 2010 and 2011 for a taxpayer with modified adjusted gross income (Personal Income Tax Law) or preapportioned income (Corporation Tax Law) of $300,000 or more.[1] However, deductions for NOL carrybacks from taxable years beginning on or after January 1, 2013, are allowed. As a result of the suspension, the NOL carryover period is extended by one year for NOLs incurred in taxable year 2010.

THIS BILL

This bill would allow the “safe harbor” treatment for determining a fraudulent investment loss as set forth in the IRS’s Revenue Procedure 2009-20[2] when the same procedures are applied for both state and federal purposes.

This bill would allow a state NOL resulting from the application of the terms of the revenue procedure the same carryback and carryforward periods as would be allowed by federal law for the same tax year and would conform by reference to the federal statute of limitations rules with respect to NOL carrybacks for losses attributable to application of the revenue procedure.

This bill would exempt NOLs arising from a fraudulent investment loss from the existing suspension period.

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[1] “Modified adjusted gross income” means the amount required to be shown as adjusted gross income on the federal tax return for the same taxable year without taking into consideration the NOL deduction under the Personal Income Tax Law. “Preapportioned income” means net income after state adjustments before the application of the apportionment and allocation provisions under the Corporation Tax Law.

[2] http://www.irs.gov/irb/2009-14_IRB/ar11.html

This bill would preclude the department from challenging the treatment of a loss determined under the terms of the revenue procedure.

TECHNICAL CONSIDERATIONS

This bill would be specifically operative for taxable years beginning on or after January 1, 2008. IRS Revenue Procedure 2009-20 would not re-open the recently-closed statute of limitations (SOL) for 2008 calendar year taxpayers. If the author's intent is to include unclaimed fraudulent investment losses for 2008 in the scope of this bill, the author may wish to amend the bill to include a limited period, after the bill is chaptered, for taxpayers to file a claim for previously unclaimed fraudulent investment losses for any 2008 taxable year that the SOL has expired.

Additionally, amendments 1 through 10 are suggested to make minor technical modifications to the "relating to" labels of IRC sections, subsections, paragraphs, etc.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 797 As Amended January 6, 2014 Enactment Assumed After June 30, 2014 ($ in Millions)			
2013-14	2014-15	2015-16	2016-17
- $5.6	+ $3.3	+ $2.1	+ $0.5

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

SUPPORT/OPPOSITION[3]

Support: State Treasurer Bill Lockyer; Board of Equalization, Jerome E. Horton; Board of Equalization, Betty T. Yee; Contra Costa County Treasurer-Tax Collector Russell Watts; San Bernardino County District Attorney Michael Ramos; California Taxpayers' Association; and seven individuals.

Opposition: Unknown.

LEGISLATIVE STAFF CONTACT

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[3] From the bill analysis prepared by the Senate Governance and Finance Committee for the bill as amended January 6, 2014.

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FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO SB 797, AS AMENDED JANUARY 6, 2014

AMENDMENT 1

On page 2, line 16, strikeout "loss" and insert:

losses

AMENDMENT 2

On page 2, line 23, after "Code,", insert:

relating to net operating loss deduction,

AMENDMENT 3

On page 2, line 31, after "Code,", insert:

relating to net operating loss deduction,

AMENDMENT 4

On page 3, line 1, strikeout "Code", and insert:

Code, relating to net operating loss deduction,

AMENDMENT 5

On page 4, line 3, after "net operating loss", insert:

carryback

AMENDMENT 6

On page 4, line 10, after “relating to”, strikeout:

the

AMENDMENT 7

On page 4, line 30, strikeout “loss”, and insert:

losses

AMENDMENT 8

On page 4, line 37, after “net operating loss”, insert:

deduction

AMENDMENT 9

On page 5, line 5, after “Code,”, insert:

relating to net operating loss deduction,

AMENDMENT 10

On page 5, line 10, strikeout “Code”, and insert:

Code, relating to net operating loss deduction,