Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Wolk & Dodd	Analyst:	Narinder Dosanjh	Bill Number:	SB 35
Related Bills:	See Legislative History	Telephone:	845-5275	Introduced Date:	December 1, 2014
		Attorney:	Bruce Langston	Sponsor	

SUBJECT:	Disaster Loss Deduction/August 2014, Napa, Solano, and Sonoma Counties

SUMMARY

This bill would, under the Personal Income Tax Law and Corporation Tax Law, allow disaster loss treatment for losses sustained in specified counties as a result of the August 2014 earthquake.

RECOMMENDATION

No position.

Summary of Suggested Amendments

Amendment 1 is suggested to resolve a technical concern.

REASON FOR THE BILL

The reason for the bill is to provide tax relief to affected persons allowing them to maintain essential basic services, repair damage, and restore their homes and businesses.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective and operative immediately upon enactment.

FEDERAL/STATE LAW

Disaster Losses

Under federal and state law, a disaster loss occurs when business or personal property is completely or partially destroyed as a result of a fire, storm, flood, or other natural event.

Federal law, Internal Revenue Code (IRC) Section 165(i), allows a taxpayer that suffers a disaster loss to elect to deduct the loss in the year immediately preceding the year the disaster occurred if it is a Presidentially-declared disaster loss.

Similarly, a California taxpayer can elect to file an amended return to deduct a disaster loss in the taxable year prior to the loss year, for any Presidentially-declared disaster. The election is not available for a Governor-only declared disaster area until enabling state legislation has been enacted.

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Existing federal and state law allows an individual taxpayer with a disaster loss that is not reimbursed by insurance or otherwise, to deduct disaster losses to the extent that each loss exceeds $100 and aggregate net losses for the taxable year exceed 10 percent of adjusted gross income. Business and income-producing property are not subject to these limitations.

If a disaster loss deduction creates a net operating loss (NOL), then carry forward treatment and carryback treatment apply.

State Net Operating Loss (NOL) Carryback Rules

Beginning on or after January 1, 2013, NOLs must be carried back to each of the preceding two tax years, unless an election to waive the carryback is made. Any excess loss may be carried forward for 20 years starting with the tax year that generated the loss. The NOL carryback may not be carried back to a tax year beginning before January 1, 2011. The allowable NOL carryback percentage increases during a phase-in period, which varies by the loss year, as shown in the table below:

NOL Incurred in Tax Year[1]	NOL Carryback Percentage
2015 and after	100%
2014	75%
2013	50%

PROGRAM BACKGROUND

On August 24, 2014, the Governor proclaimed a state of emergency for the counties of Napa, Sonoma, and Solano as a result of the South Napa Earthquake that occurred in August 2014.

The President made a Major Disaster Declaration for Napa and Solano counties on September 11, 2014; therefore, a taxpayer in these counties could file an amended return to deduct a disaster loss in the taxable year prior to the loss year. This disaster loss treatment would not apply to a taxpayer in Sonoma County because this county was excluded from the President's declaration.

THIS BILL

This bill would allow losses as defined by IRC Section 165(i) that were sustained in Sonoma County as a result of the South Napa Earthquake that occurred in August 2014.[2]

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[1] Pursuant to Revenue and Taxation Code (R&TC) 17276.20 & 24416.20.
[2] As discussed in the Background Section of the analysis, although the bill also identifies Napa and Solano Counties, the President's declaration of a disaster in Napa and Solano Counties made IRC §165(i) applicable to disaster losses in those counties.

The election under IRC Section 165(i) for the South Napa Earthquake losses could be made on a return or amended return filed on or before the due date of the return (**including the extended due date**) for the taxable year in which the disaster occurred.

Additionally, this bill would preclude any law, other than those specific to NOL treatment under the Revenue and Taxation Code[3], that suspends, defers, reduces, or otherwise diminishes the deduction of a net operating loss from applying to an NOL attributable to a loss sustained in the Counties of Napa, Solano, and Sonoma as a result of the South Napa Earthquake that occurred in August 2014.

IMPLEMENTATION CONSIDERATIONS

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

TECHNICAL CONSIDERATIONS

The language of the bill contains duplicate wording on page 3 lines 5 and 6. Amendment 1 is provided to resolve this technical concern.

LEGISLATIVE HISTORY

AB 922 (Maienschein, Chapter 352, Statutes of 2014) allows disaster loss treatment for losses sustained as a result of the wildfires that occurred in May, 2014, in San Diego County.

AB 2332 (Hernandez, Chapter 203, Statutes of 2012) allows disaster loss treatment for losses sustained as a result of the severe storms that occurred in March, 2011, in Santa Cruz County.

AB 1428 (Chesbro, Chapter 283, Statutes of 2011) allows disaster loss treatment for losses sustained as a result of the Tsunami wave surge in Mendocino County.

AB 2136 (Perez, et al., Chapter 461, Statutes of 2010) allows special disaster loss treatment for losses sustained as a result of the April 2010 Imperial County earthquake.

AB 1662 (Portantino, et al., Chapter 447, Statutes of 2010) allows disaster loss treatment for losses sustained as a result of the August 2009 Los Angeles and Monterey Counties wildfires and the January 2010 Calaveras, Imperial, Los Angeles, Orange, Riverside, San Bernardino, San Francisco, and Siskiyou Counties winter storms.

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.

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[3] Revenue and Taxation Code Sections 17276.20 and 24416.20.

Illinois, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state tax returns either in the preceding year or in the year of the loss. It appears that legislation, executive order, or proclamation by the President or the Governor is required to identify the area impacted by a disaster that is eligible for federal or state assistance.

Florida does not have a personal income tax; however, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. *Florida* also requires legislation, executive order, or proclamation to identify the area impacted by a disaster.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 35 As Introduced December 1, 2014 Assumed Enactment After June 30, 2015 ($ in Dollars)		
2013-14	2014-15	2015-16
- $1,000	+ $500	+ $500

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

Revenue Discussion:

The revenue impact of this bill would depend on the number of affected taxpayers in Sonoma County that elect to amend their prior year return to report disaster loss treatment rather than casualty loss treatment and the corresponding amount of the disaster loss deduction reported on these returns.

On September 11, 2014, President Obama declared Napa and Solano counties as disaster areas, giving residents the option to file a disaster loss return for the year immediately preceding the disaster. This bill would extend the same option to taxpayers in Sonoma County affected by the South Napa Earthquake (eligible taxpayers). Because bills are generally expected to be passed after the April 15, 2015, original filing date, this estimate assumes most eligible taxpayers will have already filed their 2014 tax returns and reported the earthquake related losses as casualty losses. The revenue impact of this bill is primarily attributable to the fact that 100 percent of disaster losses can be carried back compared to 75 percent of casualty losses. Because the difference is small, this estimate assumes that only one percent of eligible taxpayers would file an amended return to recharacterize a reported casualty loss as a disaster loss.

SUPPORT/OPPOSITION

Support: City of Napa; the County Board of Supervisors for Napa, Solano, and Sonoma Counties.

Opposition: None provided.

ARGUMENTS

Proponents: Some taxpayers may say that this bill would provide needed assistance to victims of the South Napa Earthquake by allowing them to claim the disaster loss on their prior year's tax return.

Opponents: Some taxpayers may say that individual disaster bills are costly to the state and that these expenditures should be avoided.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 35
AS INTRODUCED December 1, 2014

AMENDMENT 1

On page 3, line 5 strikeout "allow" and on line 6 strikeout "them to".