Franchise Tax Board

# ANALYSIS OF AMENDED BILL

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| Author: | Hill and Mullin | Analyst: | Diane Deatherage | Bill Number: | SB 681 |
| Related Bills: | See Legislative History | Telephone: | 845-4783 | Amended Dates: | June 29, & July 16, 2015 |
| | | Attorney: | Bruce Langston | Sponsor | |

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| **SUBJECT:** | Business Expense Deduction Shall Not Apply to Specified Expenses Paid by Pacific Gas and Electric Company |

## SUMMARY

This bill would prohibit Pacific Gas and Electric Company (PG&E) from deducting certain expenses and expenditures, under the Corporation Tax Law (CTL).

## RECOMMENDATION

No position.

### Summary of Amendments

The June 29, 2015, amendments added a coauthor, and removed provisions of the bill related to civil law and replaced them with provisions related to trade or business expenses.

The July 16, 2015, amendments removed the provisions related to trade or business expenses and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

## REASON FOR THE BILL

The reason for this bill is to prohibit PG&E from receiving a tax benefit from the payment of the economic sanctions levied in response to the San Bruno pipeline explosion.

## EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

## PROGRAM BACKGROUND

The California Public Utilities Commission (Commission) ordered PG&E and its shareholders to pay $1.6 billion for the unsafe operation of PG&E's gas transmission system, including the pipeline rupture in San Bruno, California, in 2010.

| Board Position: | | | | | | Executive Officer | Date |
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The Commission's decision[1] ordered PG&E to pay $850 million in gas transmission pipeline safety infrastructure improvements, most of which will be spent on capital investments that PG&E will not add to its rate base and thus will not earn any profit on; $300 million in a fine to the state's General Fund; $400 million in a one-time bill credit spread across PG&E's gas customers; and approximately $50 million towards other remedies to enhance pipeline safety.

The Commission ordered that the penalties and remedies assessed against PG&E must be paid by shareholders and are not recoverable from PG&E's customers.

**FEDERAL/STATE LAW**

Current federal and state 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. Under current federal and state laws, a deduction is allowed for a fine or similar penalty paid to an entity other than the government as an ordinary and necessary business expense.

**THIS BILL**

This bill would disallow a deduction for any amount paid or incurred by PG&E for expenses or expenditures identified by the Commission in Decision 15-04-024, relating to any of the following:

(1) Up to $850 million in future gas infrastructure improvements related to transmission pipeline safety to be paid for by PG&E shareholders.

(2) $400 million in bill credits for the gas ratepayers of PG&E.

(3) Approximately $50 million to implement 75 remedies, including, but not limited to implementation of pipeline safety remedies and reimbursement of the Commission for its costs incurred in investigating and enforcing violations of law relating to the public safety by PG&E.

Also, this bill would require that PG&E provide with its return for any taxable year for which expenses or expenditures have been paid or incurred that are identified in the Commission's decision, a certification, under penalty of perjury, that none of those expenses or expenditures were taken into account, directly or indirectly, in determining the amount of income of PG&E, or any other related taxpayer that is subject to the CTL for that taxable year.

**IMPLEMENTATION CONSIDERATIONS**

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

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[1] Decision 15-04-024, "Decision on Fines and Remedies to be Imposed on Pacific Gas and Electric Company for Specific Violations in Connection with the Operation and Practices of its Natural Gas Transmission System Pipelines," dated April 9, 2015.

## LEGISLATIVE HISTORY

AB 877 (Bocanegra, Chapter 792, Statutes of 2014) prohibited professional sports franchise owners from deducting fines and penalties imposed by the franchise's governing professional sports league.

AB 458 (Wieckowski, 2013/2014) was substantially identical to AB 1276 and would have disallowed the deduction of punitive damages paid or incurred in connection with any judgment in, or settlement of, any action. AB 458 failed to pass out of the Senate.

AB 1276 (Feuer, 2011/2012) 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 two-thirds 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 expenses and expenditures this bill would disallow.

## FISCAL IMPACT

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

## ECONOMIC IMPACT

We are unable to provide an estimate because doing so would violate the Franchise Tax Board's taxpayer confidentiality laws.

## SUPPORT/OPPOSITION[2]

Support: None provided.

Opposition: California Taxpayers Association.

## ARGUMENTS

Proponents: Proponents may argue that eliminating the deductibility of these expenses and expenditures would further enforce the punishment of an unacceptable behavior or action.

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[2] From Senate Governance and Finance Committee analysis, dated July 13, 2015.

Opponents: Opponents may argue that eliminating the deductibility of these expenses and expenditures would be unduly punitive and overly narrow.

**LEGISLATIVE STAFF CONTACT**


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