STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

Author: Brough	Sponsor: Three-Member FTB	Bill Number: AB 2855
Analyst: Jon Feenstra	Phone: (916) 845-4870	Amended: April 18, 2018
Attorney: Bruce Langston	Related Bills: See Prior Analysis	

Subject: Net Operating Loss (NOL) Deduction Carryback/Modified Conformity

Summary

This bill would establish an application for a tentative refund (ATR) process, similar to the federal process for obtaining a tentative refund based on an NOL carryback, and specify the trigger date for the statute of limitations (SOL) and interest accrual applicable to an NOL carryback.

Recommendation

On December 7, 2017, the three-member Franchise Tax Board voted 2-0 to sponsor the language included in this bill, with the representative of the Department of Finance abstaining.

Summary of Amendments

The April 18, 2018, amendments modified the ATR processing period, replaced an obsolete cross reference, and made a number of technical corrections. The amendments resolved the technical consideration discussed in the department's analysis of the bill as introduced on February 16, 2018.

Except for the "This Bill," "Technical Considerations," "Economic Impact," and "Support/Opposition" sections, the remainder of the department's analysis of the bill as introduced on February 16, 2018, still applies. The "Implementation Considerations," "Fiscal Impact," and "Policy Concerns" sections have been restated below for convenience.

This Bill

This bill would establish an ATR process, similar to the federal process for obtaining a tentative refund based on an NOL carryback, and specify the trigger date for the SOL and interest accrual applicable to an NOL carryback, as described below.

ATR Process

In modified conformity to federal law, this bill would amend state law to establish an ATR process. Under this process, an ATR would be filed to report an NOL carryback. The ATR, (which could be on a single-issue amended return form) must be filed within 12 months of the end of the taxable year the NOL was generated and the Franchise Tax Board (FTB) would have the later of 180 days, or the last day of the month of the extended due date for the loss year return, to process the ATR.

Amounts in excess of the overpayment attributable to the carryback would be assessed as an overstatement of a credit pursuant to Revenue and Taxation Code section 19054.

NOL Carryback – SOL and Interest Accrual Trigger Dates

This bill would also mirror federal law regarding the SOL and interest accrual trigger dates applicable to an NOL carryback.

The SOL for claiming a refund based on, or assessing a deficiency attributable to, an NOL carryback would generally be the same as the SOL for the return that generated the NOL, including extensions.

The trigger date for interest accrual would be the same as the original filing date for the return that generated the NOL, exclusive of extensions.

Implementation Considerations

The FTB's automated processing systems are tax return-based and a new standalone ATR form could not be processed through existing filing systems without significant system modifications. An ATR on a single-issue amended return with corresponding form instructions would provide relatively small processing impacts while inputting data into FTB systems and serving the same function as a standalone ATR.

The department's data processing systems are unable to easily accommodate the changes required to automate the processing of reduced period interest calculations. As a result, carryover loss overpayment interest calculations that begin on the loss year filing due date would be processed manually.

Fiscal Impact

Staff estimates a cost of approximately $571,000 in fiscal year 2018-2019 and ongoing costs of $179,000 to develop, program, and test revisions to existing systems for this bill. The department will pursue a budget change proposal if necessary.

The estimated cost for this bill is significantly lower than the estimate prepared for a similar bill, AB 1984 (Harkey, 2013/2014), because this estimate is based on historical return processing information for NOL carryback returns that was unavailable at the time the earlier bill was developed.

Economic Impact

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of AB 2855 as Amended April 18, 2018
For Taxable Years Beginning On or After January 1, 2019
Assumed Enactment after June 30, 2018

($ in Millions)

Fiscal Year	2019-2020	2020-2021	2021-2022
Revenue Impact of Interest	+ $2.1	+ $2.2	+ $2.2
Revenue Impact of SOL	+ $3.4	+ $3.5	+ $3.6
Revenue Impact of Refund	- $55.0	- $10.0	- $2.4
Total*	- $50.0	- $4.5	+ $3.3

*Totals do not add due to rounding.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

The revenue impact of the proposal was estimated using data on carryback refunds claimed by taxpayers against taxes paid during the 2011-2015 period.

The proposal changes the date that the FTB must begin interest accrual to be the original filing date for the return that generated the NOL, exclusive of extensions. This change would reduce the amount of interest paid on these refunds by approximately one year for NOLs carried back one year and by approximately two years for NOLs carried back two years. Based on an analysis of carrybacks reported on corporate tax returns, the estimate assumes that 70 percent of losses in a year are carried back two years and 30 percent one year. The applicable corporate and personal overpayment interest rates are applied to these refund claims. This interest rate was applied to the refund claims that were allowed by FTB. The revenue gain from this change is approximately $2.2 million per year.

Currently, if the FTB allows a refund for a carryback, and later audits the loss year and reduces the NOL amount, it may be barred by the SOL from adjusting the refund amount. This estimate assumes that five percent of amounts refunded as carrybacks would be reversed by audits after the SOL expires. This proposal would enable the FTB to recoup these refunds. The revenue gain from this change is approximately $3.5 million per year.

When the FTB receives a refund request based on an NOL carryback, the return is examined quickly to identify issues that may affect the amount of the refund. The FTB is currently releasing $30 million in refunds after this initial examination and holding onto about $50 million in refund requests pending further examination. This proposal would require the FTB to release refunds within 180 days of receiving a carryback ATR, or the last day of the month of the extended due date for the loss year return. For refunds that the FTB ultimately approves, this accelerates the date of the refund, resulting in an initial cash outflow and a later, offsetting cash inflow. For refunds that the FTB ultimately denies this results in a refund that would not have been issued under current law followed by a repayment from the taxpayer after an audit assessment, also resulting in an initial cash outflow and a later, offsetting cash inflow. The initial net outflow of revenue from this proposal is $50 million.

The tax-year estimates are converted to fiscal years, accrued back one year, and then rounded as reflected in the above table.

Support/Opposition[1]

Support: Three-Member Franchise Tax Board (Sponsor), California Society of Enrolled Agents, and San Gabriel Valley Economic Partnership.

Opposition: None provided.

Policy Concerns

Allowing an expedited ATR process and mirroring the federal SOL and interest accrual trigger-date applicable to NOL carrybacks would simplify the preparation of amended state tax returns for affected entities for the specified taxable years. However, if California conforms to recent changes to federal law that eliminated nearly all NOL carrybacks, the provisions of this bill would be largely unnecessary since they would only apply to a very limited number of taxpayers.

Legislative Staff Contact

Jon Feenstra
Legislative Analyst, FTB
(916) 845-4870
jon.feenstra@ftb.ca.gov

Jame Eiserman
Revenue Manager, FTB
(916) 845-7484
jame.eiserman@ftb.ca.gov

Diane Deatherage
Legislative Director, FTB
(916) 845-6333
diane.deatherage@ftb.ca.gov

[1] From analysis by the Assembly Committee on Revenue and Taxation, dated April 6, 2018.