Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Ridley-Thomas	Analyst:	Jon Feenstra	Bill Number:	AB 454
Related Bills:	See Legislative History	Telephone:	845-4870	Introduced Date:	February 13, 2017
		Attorney:	Bruce Langston	Sponsor:	

SUBJECT: Exclusion for Wrongfully Incarcerated Individuals

SUMMARY

This bill would conform to the federal exclusion from gross income of certain amounts received by wrongly incarcerated individuals.

RECOMMENDATION – NO POSITION

REASON FOR THE BILL

Criminal justice advocates report that compensation awards are not treated evenly under state law. This bill would provide both certainty and uniformity by clearly exempting wrongful incarceration awards from state taxation, thereby providing relief to those who have suffered a miscarriage of justice by being wrongfully incarcerated.

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, 2017.

FEDERAL/STATE LAW

Under federal and state law, the taxability of damages (amounts received as a result of a claim or legal action for compensation for injury) depends upon the nature of the underlying claim. If a direct payment on the underlying claim would be includible as income under the federal gross income provision,[1] and no specific exemption for that type of income is otherwise provided, then damages intended to compensate for loss of that income are themselves includible in income.[2]

Internal Revenue Code (IRC) section 139F, specifically excludes from the gross income of a wrongfully incarcerated individual any civil damages, restitution, or other monetary award (including compensatory or statutory damages and restitution imposed in a criminal matter) relating to the incarceration of such individual for the covered offense for which such individual was convicted.

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[1] IRC section 61.

[2] For example, a claim for lost wages results in taxable damages, because the wages themselves would have been taxable, but an award for damage to property may not result in includible income if the award does not exceed the recipient’s basis in the property.

A wrongfully incarcerated individual means:

- An individual who was convicted of a covered offense and served all or part of a sentence of imprisonment relating to that covered offense; and
    - The individual was pardoned, granted clemency, or granted amnesty for that offense because the individual was innocent of that covered offense, or
    - The judgment of conviction for the covered offense was reversed or vacated, and the indictment, information, or other accusatory instrument for that covered offense was dismissed, or the individual was found not guilty at a new trial after the judgment of conviction for that covered offense was reversed or vacated.

For these purposes, a covered offense is any criminal offense under federal or state law, and includes any criminal offense arising from the same course of conduct as that criminal offense.

Under federal law if the claim for credit or refund was filed before the close of the one-year period beginning on December 18, 2015, an individual could have made a claim for credit or refund of any overpayment of tax resulting from the exclusion, even if such claim would have been otherwise disallowed under the IRC or by operation of any law or rule of law (including res judicata).[3]

California generally conforms to amounts includible in gross income under IRC section 61, and generally conforms to federal exclusions provided in Part III of Subchapter B of Chapter 1 of the IRC, Items Specifically Excluded from Gross Income (commencing with IRC section 101), as of the “specified date” of conformity of January 1, 2015. IRC Section 139F was enacted into law on December 18, 2015, thus, California does not conform to the federal exclusion for wrongfully incarcerated individuals.

California excludes from gross income any amount received in any taxable year by a claimant pursuant to Section 4904 of the California Penal Code,[4] meaning California law excludes only state appropriations made pursuant to that section.

THIS BILL

This bill would, for amounts received on or after January 1, 2017, conform to IRC section 139F, that excludes from gross income certain amounts received by wrongly incarcerated individuals. However, because the bill does not expressly conform to Section 304(d) of Public Law (PL) 114-113, relating to waiver of limitations, the federal provision that allowed retroactive claims for a limited time period would be unavailable.

[3] The enactment date of the Protecting Americans from Tax Hikes Act of 2015, PL 114-113.
[4] Revenue and Taxation Code section 17157.

IMPLEMENTATION CONSIDERATIONS

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

LEGISLATIVE HISTORY

AB 1799 (Baugh, Chapter 630, Statutes of 2000) excludes from gross income certain amounts received by individuals from the state due to erroneous criminal conviction and incarceration.

OTHER STATES' INFORMATION

Illinois, Massachusetts, *Michigan,* and *New York* laws conform to the federal income exclusion for wrongfully incarcerated individuals. *Minnesota* does not conform to the federal income exclusion. The laws of these states were selected due to their similarities to California's economy, business entity types, and tax laws.

FISCAL IMPACT

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

ECONOMIC IMPACT

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 454 As Introduced February 13, 2017 Assumed Enactment After June 30, 2017		
2017-18	2018-19	2019-20
- $60,000	- $30,000	- $30,000

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

Revenue Discussion

This revenue estimate is based upon a proration of the Joint Committee on Taxation (JCT) estimate for the Protecting Americans from Tax Hikes Act of 2015 for exclusion for wrongly incarcerated individuals. In December 2015, the JCT estimates the federal revenue impact of the exclusion to be $1 million loss in fiscal year 2018. The equivalent loss to California is estimated to be $30,000 ($1 million * 10% = 100,000, then $100,000 – 70,000 [100,000 * 70%]) = $30,000) in tax year 2018.

To determine California's share of the federal loss, data from The National Registry of Exonerations was used to calculate that approximately 10 percent of exonerations take place in California. Then the estimate was reduced by 70 percent to reflect the differences between federal and state tax rates.

The tax-year estimates are converted to fiscal years, and then rounded to arrive at the amounts reflected in the above table.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Some might argue that this bill would provide both certainty and uniformity by clearly exempting awards to wrongly incarcerated individuals from state taxation.

Opponents: Some may argue that awards received are income to the recipient and should remain subject to state tax.

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
dane.deatherage@ftb.ca.gov