BILL ANALYSIS

<table>
<thead>
<tr>
<th>Department, Board, Or Commission</th>
<th>Author</th>
<th>Bill Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Franchise Tax Board</td>
<td>Ridley-Thomas</td>
<td>AB 454</td>
</tr>
</tbody>
</table>

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.

REASON FOR THE BILL

Criminal justice advocates report that compensation awards are treated unevenly 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

This bill would be effective January 1, 2018, and specifically operative for taxable years beginning before, on, or after January 1, 2018. This bill would also specifically allow otherwise barred credits or refunds relating to the retroactive conformity to the exclusion provision made by this bill for a one-year period beginning on January 1, 2018.

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, 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.

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1 Internal Revenue Code (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.
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.

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, under the PITL, for amounts received before, on, or after January 1, 2018, conform to IRC section 139F, that excludes from gross income certain amounts received by wrongly incarcerated individuals.

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³ The enactment date of the Protecting Americans from Tax Hikes Act of 2015, PL 114-113.
⁴ Revenue and Taxation Code section 17157.
Additionally, any credit or refund that would be barred by statute or rule of law, including res judicata, would be allowed if claimed before the close of the one-year period beginning on the effective date of this bill.

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:

<table>
<thead>
<tr>
<th>Year</th>
<th>Estimated Revenue Impact of AB 454</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Assumed Enactment By September 30, 2017</td>
</tr>
<tr>
<td>2016-17</td>
<td>$-60,000</td>
</tr>
<tr>
<td>2017-18</td>
<td>$-60,000</td>
</tr>
<tr>
<td>2018-19</td>
<td>$-30,000</td>
</tr>
<tr>
<td>2019-20</td>
<td>$-30,000</td>
</tr>
</tbody>
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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 estimated 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 in taxable 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.

In addition, it is assumed individuals that received payments prior to the enactment of this bill would amend their returns to exclude income received.
The tax-year estimates are converted to fiscal years, and then rounded to arrive at the amounts reflected in the above table. The amounts related to prior year amended returns are accrued back one year.

**APPOINTMENTS**

None.

**SUPPORT/OPPOSITION\(^5\)**


Opposition: None provided.

**VOTES**

<table>
<thead>
<tr>
<th>Date</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concurrence</td>
<td>09/14/17</td>
<td>79  0</td>
</tr>
<tr>
<td>Senate Floor</td>
<td>09/14/17</td>
<td>40  0</td>
</tr>
<tr>
<td>Assembly Floor</td>
<td>04/20/17</td>
<td>74  0</td>
</tr>
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**LEGISLATIVE STAFF CONTACT**

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<tr>
<th>Contact</th>
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\(^5\) From Senate Committee on Governance and Finance dated June 23, 2017.