



Bill Analysis

Author: Kiley

Sponsor:

Bill Number: AB 2166

Analyst: Jon Feenstra

Phone: (916) 845-4514

Amended: May 4, 2020

Attorney: Shane Hofeling

Related Bills: See Legislative
History

SUBJECT

Net Operating Loss (NOL) Carryover Conformity

SUMMARY

This bill would, under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), conform to federal law by allowing a five year carryback of an NOL incurred in a taxable year that begins on or after January 1, 2018, and before January 1, 2021, and allow an election to file a short period return for the first six months of a taxable year in which such an NOL is incurred.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

The May 4, 2020, amendments replaced the provisions that would have, under the PITL, allowed a qualified taxpayer a refundable tax credit for amounts paid or incurred on the purchase of a qualified principal residence fire insurance policy, with the provisions being discussed in this bill analysis.

REASON FOR THE BILL

The reason for this bill is to provide immediate capital to California businesses currently suffering from unexpected economic difficulties caused by the COVID-19 pandemic.

ANALYSIS

This bill would, under the PITL and CTL, conform to Internal Revenue Code (IRC) section 172(b)(1)(D)(i)¹ which among other things,² allows a five year NOL carryback for losses incurred in taxable years beginning in 2018, 2019, and 2020. In addition, this bill would allow a taxpayer that incurs an NOL in those taxable years, and is eligible for the five year carryback, to elect to file a short period return for the first six months of the taxable year, which would be due on September 1st of the taxable year.

¹ As added by Section 2303(b)(1) of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act).

² Such provisions are not relevant under the Revenue and Taxation Code (R&TC).

In un-codified law this bill would, for purposes of complying with Section 41 of the R&TC:

- Define the goal, purpose, or objective of the tax deduction as jumpstarting California's economic recovery and helping bring back the millions of jobs that have been lost as a result of the COVID-19 pandemic.
- Specify that the performance indicator measuring whether the deduction meets the above goal, purpose, or objective is how many taxpayers are allowed the NOL deduction under the provisions of this bill.
- Require the Franchise Tax Board (FTB) to annually publish on its internet website the number of taxpayers allowed the NOL deduction under the provisions of the bill, notwithstanding the general prohibition on disclosure under R&TC section 19542.

Effective/Operative Date

This bill would be effective on January 1, 2021, and apply to losses generated in taxable years beginning on or after January 1, 2018, and before January 1, 2021.

Federal/State Law

Federal Law

An NOL generally means the amount by which a taxpayer's business deductions exceed its gross income. A taxpayer generally may deduct in a taxable year an NOL carried to such year.

Prior to the CARES Act

For NOLs arising in taxable years beginning after December 31, 2017, the NOL deduction generally is limited to 80 percent of taxable income determined without regard to the NOL deduction. Excess losses generally may be carried forward indefinitely, but not back, and carryovers of such NOLs to other taxable years are adjusted to take account of the 80-percent taxable income limitation. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.

Special rules apply with respect to NOLs arising in certain circumstances. These include a special rule providing a two-year carryback in the case of certain farming losses. A separate special rule provides a two-year carryback and 20-year carryover for NOLs of a property and casualty insurance company (i.e., an insurance company as defined in IRC section 816(a) other than a life insurance company). Further, the 80-percent taxable income limitation does not apply to the NOLs of such insurance companies.

NOLs arising in taxable years beginning before January 1, 2018, are not subject to the 80-percent taxable income limitation. Further, such NOLs remain subject to the 20-year carryover limitation and the relevant carryback rules in effect for taxable years beginning before January 1, 2018.

A taxpayer with NOL carryovers to a taxable year from both taxable years beginning before 2018 and taxable years beginning after 2017 computes its tax liability as follows. First, the taxpayer may deduct an NOL in the amount of its pre-2018 NOL carryovers without limitation. Second, the taxpayer may deduct an additional NOL equal to the lesser of (1) its post-2017 NOL carryovers or (2) 80 percent of the excess (if any) of the taxpayer's taxable income (before any NOL deduction attributable to post-2017 NOL carryovers) over the NOL deduction attributable to pre-2018 NOL carryovers.

Changes Made by the CARES Act

The CARES Act suspends the application of the 80-percent taxable income limitation for taxable years beginning after December 31, 2017, and before January 1, 2021.³

The 80-percent taxable income limitation continues to apply in the case of any taxable year beginning after December 31, 2020, and with respect to NOLs arising in taxable years beginning after December 31, 2017, carried to such a taxable year.⁴

The CARES Act also modifies the rules relating to NOLs arising in 2018, 2019, and 2020.⁵ Specifically, any NOL arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, may be carried back to the five taxable years preceding the taxable year of such loss.⁶

State Law

Over the years, there have been several changes to the California NOL provisions. In general, California allows a taxpayer to calculate an NOL in accordance with federal rules, but has not conformed to the federal changes that apply to taxable years beginning after December 31, 2017.

³ IRC section 172(a).

⁴ IRC section 172(a)(2). IRC section 172(a)(2)(A) provides that NOLs arising in taxable years beginning before January 1, 2018, carried to a taxable year beginning after December 31, 2020, are not subject to the 80-percent taxable income limitation.

⁵ IRC section 172(b)(1)(D).

⁶ See IRC section 172(b)(1)(D)(i). Pursuant to IRC section 172(b)(2), any NOL carryback must be carried to the earliest taxable years to which such loss may be carried. NOLs eligible for the five-year carryback period include, for example, those arising with respect to farming losses, which would otherwise be subject to a two-year carryback period. See, e.g., IRC section 172(b)(1)(B).

NOLs attributable to taxable years beginning on or after January 1, 2008, may be carried forward 20 years. For NOLs attributable to taxable years beginning before January 1, 2013, NOL carrybacks are unavailable. California conforms to the federal NOL carryback rules for NOLs attributable to taxable years beginning on or after January 1, 2013, and before January 1, 2019, with modifications.

California law provides that losses generated in taxable years beginning on or after January 1, 2013, and before January 1, 2019, are allowed to be carried back to the two preceding taxable years. No losses may be carried back to years beginning before January 1, 2011, or on or after January 1, 2019.

The carryback was phased in as follows:

- 50-percent of the NOL generated in taxable years beginning in 2013 is eligible for a two-year carryback.
- 75-percent of the NOL generated in taxable years beginning in 2014 is eligible for a two-year carryback.
- 100-percent of the NOL generated in taxable years beginning in 2015 through 2018 is eligible for a two-year carryback.

For taxable years beginning in 2008 and 2009, California suspended the NOL carryover deduction. Taxpayers continued to compute and carryover their NOL during the suspension period. However, individuals with a net business income of less than \$500,000, and corporations with taxable income of less than \$500,000, were not affected by the NOL suspension rules.

Also, for taxable years beginning in 2010 and 2011, California suspended the NOL carryover deduction. Taxpayers continued to compute and carryover NOLs during the suspension period. However, individuals with a modified adjusted gross income of less than \$300,000, and corporations with net income less than \$300,000, were not affected by the NOL suspension rules.

The carryover period for any NOL or NOL carryover, for which a deduction is disallowed because of the 2008-2011 suspension, are extended by:

- One year for losses incurred in taxable years beginning on or after January 1, 2010, and before January 1, 2011.
- Two years for losses incurred in taxable years beginning on or after January 1, 2009, and before January 1, 2010.
- Three years for losses incurred in taxable years beginning on or after January 1, 2008, and before January 1, 2009.
- Four years for losses incurred in taxable years beginning before January 1, 2008.

Implementation Considerations

Department staff has identified the following implementation considerations for purposes of a high-level discussion; additional concerns may be identified as the bill moves through the legislative process. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The department will not complete development of the 2020 tax return forms, instructions, and processing systems until approximately December of 2020. Thus, the department would incur significant difficulties, risks, and additional costs to develop alternative tax return forms, instructions, and manual processing methods to be available for return filing during the period beginning July 1, 2020, and ending September 1, 2020.

This bill would allow an election to file a return with a due date of September 1, to carryback an NOL that was incurred in taxable years beginning on or after January 1, 2018, and before January 1, 2021. Because the bill does not have an urgency clause, it would be effective on January 1, 2021. Also, if the bill is enacted after September 1, 2020, taxpayers would be unable to file a timely return. If this is not the author's intent, the bill should be amended.

NOLs are generally calculated on an annual basis. This bill would allow taxpayers to file a return for NOLs incurred on or before June 30, 2020, without regard to the taxpayer's profits or losses incurred during the remainder of the taxable year. In order to properly account for NOLs incurred during taxable years beginning on or after January 1, 2020, there should be a mechanism added to reconcile year end NOLs to those reported on a partial year return.

This bill would allow an election to file a return with a due date of September 1, to carryback an NOL that is incurred in the first six months of 2020, in addition to NOLs already incurred in taxable years 2018 and 2019. Most tax returns would already have been filed for taxable years beginning in 2018 and 2019 and any NOLs already determined for the entire year. If this is not the author's intent the bill should be amended.

This bill would allow a five year NOL carryback for losses incurred in taxable years that begin in 2018, 2019 and 2020. To use the NOL carrybacks, claims for refund or credit would have to be filed for the carryback to earlier taxable years, some of which would be beyond the California statute of limitations (SOL) for filing claims. If this is not the author's intent, the bill should be amended to extend the SOL for NOLs that may be carried back under this bill's provisions.

Because a carryback year SOL could expire before the department could conduct an audit of an NOL carryback, it is recommended that the SOL to issue an assessment, for a year with a reported NOL carryback, be made the same as the loss year that generated the NOL carryback.

This bill is silent on when the annual data publishing requirement would begin and end. Additionally, it should be noted that complete information for a taxable year would be unavailable for approximately 18 months after the end of the taxable year in order to include data from returns filed by the extended due date, meaning that complete information for 2020 year of the NOL deduction, would be unavailable until approximately mid-year 2022. To ensure consistency with the author's intent, this bill should be amended.

Technical Considerations

Technical amendments have been identified to ensure the bill meets the author's intent. Department staff is available to work with the author's office to resolve the following technical considerations:

- On page 20, line 27, strike out "credit", and insert "deduction".
- The bill's existing section references to the IRC are as of the specified date of January 1, 2015. Amendments should be added to incorporate IRC section 172(b)(1)(D)(i) as added by Section 2303 of the CARES Act.
- Short period returns should be referenced and the method of making an election for their filing.
- Fiscal taxable year return filing should be accommodated, and timing issues relating to the enactment date of the bill should be resolved.
- Text similar to R&TC section 24416.21, under the CTL, should be included for R&TC section 17276.21, under the PITL.
- A credit or refund due to reductions of taxable income or net income due to NOL carrybacks should be allowed under this bill to taxable years that would be beyond the statute of limitations, and the carryback years SOL for issuing a notice of proposed assessment (NPA) should be changed to be the same as the loss year NPA SOL, to the extent of the amount refunded in carryback years.
- The NOL carryback provisions of the bill should be clarified to apply to NOL losses incurred in taxable years beginning in 2018, 2019, and 2020, and the filing of a first six month short period return should only be allowed for taxable years that begin during 2020.
- The short period return NOL should be reconciled to the full taxable year NOL.

Policy Concerns

By conforming to a portion of the federal law that allows NOLs, this bill would simplify the preparation of California tax returns for those years to which the provisions apply.

LEGISLATIVE HISTORY

AB 91 (Burke, Statutes of 2019, Chapter 39) disallowed the carryback of NOLs that were incurred in taxable years beginning on or after January 1, 2019, for individual and corporate taxpayers.

AB 2855 (Brough, 2017/2018) would have established an application for a tentative refund process, similar to the federal process for obtaining a tentative refund based on an NOL carryback, and specified the trigger date for the SOL and interest accrual applicable to an NOL carryback. AB 2855 failed to pass out of the Senate Appropriations Committee by the constitutional deadline.

AB 154 (Ting, Statutes of 2015, Chapter 359) conformed to the federal NOL rules that allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year.

AB 1984 (Harkey, 2013/2014) would have conformed to the federal provisions that allow a taxpayer with NOL carrybacks to obtain a tentative refund of taxes paid in prior tax years by filing a tentative carryback adjustment application, and allow a corporation to apply to extend the time for payment of taxes for the immediately preceding taxable year. AB 1984 failed to pass out of the Assembly Appropriations Committee by the constitutional deadline.

AB 2408 (Skinner, 2011/2012) would have eliminated the two-year carryback of NOLs so that NOLs could only be carried forward. AB 2408 failed to pass out of the Senate by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

This bill would allow an election for qualified taxpayers to file a short period tax return for the first six months of the 2020 taxable year, with a filing due date of September 1, 2020. The department will not complete development of the 2020 tax return forms, instructions, and processing systems until approximately December of 2020. Thus, the department would incur substantial additional costs to develop alternative tax return forms, instructions, and manual processing methods to be available for return filing after the first six months of the 2020 taxable year. Additionally, system modifications needed to accommodate short year returns could result in significant risks and costs.

As a result, this bill would impact the department's programming, printing, and processing costs for tax returns. The additional costs will be developed as the bill moves through the legislative process. It is recommended that the bill be amended to include appropriation language to secure the funding through the normal budgetary process.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue impact:

Estimated Revenue Impact of AB 2166 as Amended May 4, 2020
Assumed Enactment after June 30, 2020

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$3,200
2020-2021	-\$1,900
2021-2022	+\$115
2022-2023	+\$30

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.

Because the impact of current economic circumstances is unknown, this estimate is subject to change.

Revenue Discussion

Based on data from the Joint Committee on Taxation and FTB, it is estimated there would be approximately \$5 billion of NOLs available for use in the 2021 taxable year. It is estimated that approximately sixty-five percent, or \$3 billion, of these losses would be carried back and used against prior year income, and the remaining \$2 billion in losses would be used to offset income in taxable year 2021. It is estimated that starting in the 2022 taxable year, there would be some increases in revenue from taxpayers who no longer have available NOLs as a result of the carrybacks.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table. Losses used to offset income in prior years are accrued back to fiscal year 2019-20.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE STAFF CONTACT

Jon Feenstra
Legislative Analyst, FTB
(916) 845-4514
jon.feenstra@ftb.ca.gov

Tiffany Christiansen
Revenue Manager, FTB
(916) 845-5346
tiffany.christiansen@ftb.ca.gov

Annette Kunze
Legislative Director, FTB
(916) 845-6333
annette.kunze@ftb.ca.gov