STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Blanca Rubio	Sponsor:	Bill Number: AB 2065
	Related Bills; See Legislative History	Introduced: February 14, 2022 Amended: March 17, 2022

SUBJECT

Net Operating Loss Carryback

SUMMARY

This bill, under Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), would allow certain qualified taxpayers to carryback suspended net operating losses (NOLs) or suspended NOL carryovers in taxable years beginning on or after January 1, 2023, to taxable years beginning on or after January 1, 2020, but before January 1, 2022.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 17, 2022, amendments remove the requirement for the NOL carryback to be applied to the three preceding taxable years and instead would be applied to the 2020 and 2021 taxable years. The amendment also modifies the time period for a "qualified taxpayer" to have completed a sale of fixed assets or other property held or used in the regular course of their trade or business.

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

REASON FOR THE BILL

The reason for the bill is to provide relief to California businesses that were subject to the suspension of NOLs in 2020 and 2021.

ANALYSIS

For taxable years beginning on and after January 1, 2023, this bill would, under the PITL and the CTL, allow a qualified taxpayer to carryback NOLs or NOL carryovers, for which an NOL deduction was suspended during taxable years beginning on or after January 1, 2020, and before January 1, 2023, to taxable years beginning on or after January 1, 2020, but before January 1, 2022.

This bill defines a qualified taxpayer as one that:

1. Owned or operated a business in California during any portion of taxable years beginning on or after January 1, 2020, and before January 1, 2022, during which an NOL deduction was suspended, and
2. Completed a substantial sale of fixed assets or other property held or used in the regular course of its business, including the sale of ownership interests in a legal entity, during the taxable year beginning January 1, 2020, and before January 1, 2022.

For pass-thru entities, whether the entity is a qualified taxpayer will be determined at the entity level and the NOL carryback will be passed through to the partners or shareholders under PITL and CTL rules. A "pass-thru entity" is also defined as an entity that is taxed as a partnership or an "S" corporation for this purpose.

The bill defines "substantial sale" as one or more sales in which the total amount realized exceeds five percent (5%) of the taxpayer's gross receipts for the taxable year.

This bill contains language to comply with Revenue and Taxation Code (RTC) section 41, and states that the purposes, and objective of the bill is to resolve the disparity in timing of income and expense recognition due to the NOL deduction suspension.

Franchise Tax Board (FTB) would be required to provide a report to the Legislature and relevant committees on the estimated impact the PITL and CTL NOL carryback had to the General Fund on or before January 1, 2024.

The code sections added by this bill would be repealed on December 1, 2025.

Effective/Operative Date

This bill would be effective on January 1, 2023, and operative for taxable years beginning on or after January 1, 2023.

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 Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Public Law 116-136.)

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.

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 suspended the application of the 80-percent taxable income limitation for taxable years beginning after December 31, 2017, and before January 1, 2021. The 80-percent taxable income limitation continues to apply in the case of any taxable year beginning after December 31, 2020. The 80-percent taxable income limitation was also eliminated for NOLs arising in taxable years beginning after December 31, 2017, that were generated in taxable years beginning on or before December 31, 2017, and carried to such a taxable year. (Internal Revenue Code (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.)

The CARES Act also modified the rules regarding carrybacks for NOLs arising in 2018, 2019, and 2020. (IRC section 172(b)(1)(D).) 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. (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).)

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.

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, and after December 31, 2018, 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.

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.

In 2020, Sections 17276.23 and 24416.23 were added to the RTC, and suspend NOL carryover deductions for taxpayers with modified adjusted gross income or business income (under PITL) or income subject to tax (under CTL) of over $1,000,000 for taxable years 2020, 2021, and 2022. Under these sections, the NOL carryover period is also extended by one year for NOLs incurred in taxable year 2021, two years for NOLs incurred in taxable year 2020, and three years for NOLs incurred in taxable years beginning before 2020.

SB 113 (Chapter 3, Statutes of 2022), which was recently enacted, repealed the NOL deduction suspension for 2022 taxable years and resumes the allowance of NOL deductions for taxable years beginning on or after January 1, 2022.

Implementation Considerations

The department has identified the following implementation considerations, and is available to work with the author's office to resolve these and other considerations that may be identified.

Subdivision (b) of code Sections 17276.23 and 24416.23 allow carryover extensions of up to three years for each year the NOL carryover deduction is disallowed under subdivision (a) of those code sections. The bill does not specify whether the carryover extension under those sections would be inapplicable when a deduction is allowed for NOLs or NOL carryovers under this bill. If that is contrary to the author's intent, the bill should be amended.

The bill uses undefined term "own or operate a business" in this state to define a qualified taxpayer. Absent a definition, the term could be broadly interpreted and may lead to disputes between the department and taxpayers. For clarity and ease of administration, it is recommended that the bill be amended to use the RTC defined and commonly used term "doing business" to define a qualified taxpayer who is allowed to use the NOL.

The bill contains the undefined term "other property." The absence of a clear definition to clarify this term could lead to disputes with taxpayers and would complicate the administration of this bill. For clarity and ease of administration, it is recommended that the bill be amended.

This bill would require the department to provide the estimated General Fund impact of NOLs for both PITL and CTL by January 1, 2024. The earliest the FTB can provide data for a tax year is generally one year after the original due date of the return for individuals, and one year after the extended due date of the return for corporations. For example, for corporations, the extended due date for the 2023 tax year would generally be November 15, 2024; thus, the FTB would not have reporting data until December 2025. The author may wish to amend the bill to change the due date of the report to allow the department to collect the necessary data. Additionally, the author may wish to identify the relevant committees that will receive the report provided by the department.

Technical Considerations

It is recommended that the author amend RTC sections 17276.23 and 24416.23 to allow NOLs and NOL carryovers for the 2020 and 2021 tax years for these qualified taxpayers, instead of adding Sections 17267.24 and 24416.24 to the RTC, relating to carrybacks.

Policy Considerations

None noted.

LEGISLATIVE HISTORY

SB 113 (Committee on Budget and Fiscal Review, Chapter 3, Statutes of 2022) amongst other items, under the PITL and CTL, repealed the third year of the NOL suspension and allowed NOLs to be deducted for taxable years beginning on or after January 1, 2022.

AB 222 (Rubio, 2021/2022) would have allowed a carryback for suspended net operating loss for active solar energy systems. AB 222 did not pass out of the Assembly Revenue & Taxation Committee by the constitutional deadline.

AB 85 sections 8 and 16 (Committee on Budget, Chapter 8, Statutes of 2020) suspended NOL deductions for taxable years 2020, 2021, and 2022. The suspension of NOLs does not apply to:

- A taxpayer under the PITL, with modified adjusted gross income or net business income of less than $1,000,000.
- A taxpayer under the CTL, with income subject to tax of less than $1,000,000.

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

AB 2166 (Kiley, 2019/2020) would have conformed under PITL and CTL, to federal law by allowing a five year carryback of an NOL incurred in a taxable year that began on or after January 1, 2018, and before January 1, 2021, and allowed an election to file a short period return for the first six months of a taxable year in which such an NOL is incurred. This bill was held at the Assembly Revenue and Taxation Committee.

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 statute of limitations and interest accrual applicable to an NOL carryback. AB 2855 did not pass out of the Senate Appropriations Committee by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Discussion

To determine impact to the General Fund the number of businesses that will complete a substantial sale, as defined by the provision of this bill, and the amount of their denied losses would need to be known. Because it is difficult to predict the number of taxpayers with qualified substantial sales and their corresponding losses, a revenue impact cannot be determined. However, using a weighted average effective tax rate for personal income and corporate taxpayers, it is estimated that for every $100 million in net operating loss deductions used to offset income, there would be a revenue loss of approximately $6 million.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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