STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Rubio

Sponsor:

Bill Number: AB 222

Related Bills: See Legislative History

Introduced: January 11, 2021, Amended: March 15, 2021

SUBJECT

Net Operating Loss (NOL) Carryback for Active Solar Energy System Businesses

SUMMARY

This bill, under Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), would allow certain qualified taxpayers to carryback suspended NOLs or suspended NOL carryovers in taxable years beginning on or after January 1, 2023, to each of the three preceding taxable years.

RECOMMENDATION

No position.

SUMMARY OF AMENDMENTS

The March 15, 2021 amendment made several technical changes and refined the description of certain terms. The amendment also added Section 41 requirements.

The amendment would also task the Franchise Tax Board (FTB) with providing the general fund impact of the provisions of the bill to the legislature and relevant committees.

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

REASON FOR THE BILL

To provide relief, due to the economic impacts of the coronavirus pandemic, from the suspension of certain NOL deductions for certain solar energy system businesses with sales of a significant portion of their assets.

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 the three preceding taxable years.

This bill defines a qualified taxpayer as one that:

1. Was engaged in the business of owning, operating, or constructing active solar energy systems in California during any portion of taxable years beginning on or after January 1, 2020, and before January 1, 2023, 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, 2021.

The bill defines "substantial sale" as one or more sales in which the total amount realized exceeds 5 percent 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.

The bill would also require the FTB to provide a report with the estimated General Fund impact of the provisions of this bill to the Legislature and the relevant committees on or before January 1, 2023.

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, 2023.

Federal/State Law

Federal Law

An NOL generally means the amount by which a taxpayer's deductions exceed its gross income. A taxpayer generally may deduct in a taxable year an NOL carried to such year (Internal Revenue Code section 172).

NOLs Prior to the Coronavirus Aid, Relief, and Economic Security Act (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.

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 from taxable years beginning before 2018 and also from 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
    - its post-2017 NOL carryovers or
    - 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.

NOL 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.

The CARES Act also modified the rules regarding carrybacks for NOLs arising in 2018, 2019, and 2020. 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.

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.

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.

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.

This bill is silent on when a "substantial sale" is considered "complete" or would include a sale that commences prior to taxable years beginning on or after January 1, 2020, but before January 1, 2021. Furthermore, it is unclear which taxable year's gross receipts is used to determine whether a sale is a "substantial sale." For clarity, it is recommended that the bill be amended.

If enacted, the FTB would need to capture gross receipts on the tax return to verify if the taxpayer is qualified under this bill. This information is not captured if the business activity is operated through a sole proprietorship. The department would be required to make changes to existing tax forms, instructions, and information systems.

Under the current language substantial sale of fixed assets or other property held or used in the regular course of the taxpayer's business is considered for the determination of whether the taxpayer is qualified. If the author intends for the fixed assets and other property to be limited to active energy systems, the language would need to be amended.

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.

It is unclear what taxable year the 3 preceding taxable years starts from. For clarity, the bill should be amended.

It is unclear whether any NOL or only NOLs disallowed under subdivision (a) of Section 17276.23 and 24416.23 are allowed as an NOL carryback under these provisions. For clarity, the bill should be amended.

Technical Considerations

The following changes in terminology in sections two and three of the bill are recommended for grammatical consistency:

- Subdivision (a) of Sections 17276.24 and 24416.24 replace "on and after" with "on or after".
- Subdivision (a) and subparagraph (b)(2)(A) of Sections 17276.24 and 24416.24, replace "denied" with "disallowed".

Policy Considerations

This bill would provide a tax benefit for a specific business activity and would not be provided to other business activities.

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

This bill defines a qualified taxpayer as a taxpayer that was engaged in the business of owning, operating, or constructing active solar energy systems. As drafted, a taxpayer could meet the owning an active solar energy system based on any percentage of ownership. If this is contrary to the author's intent, the bill should be amended.

The amendments made by this bill would provide an NOL carryback to taxable years beginning after January 1, 2020, and before January 1, 2021, that could result in a refund of tax. This could be considered a gift of public funds.

LEGISLATIVE HISTORY

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.

AB 154 (Ting, Chapter 359, Statutes of 2015) 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 did not 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 did not pass out of the Senate by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

FISCAL IMPACT

If this bill is enacted, the department may incur additional costs to develop some changes to existing tax forms and instructions and information systems. As the bill moves through the legislative process, costs will be identified.

ECONOMIC IMPACT

Revenue Estimate

To determine the magnitude of the potential impact to the General Fund, both the number of qualified taxpayers as defined by the provisions of this bill and the amount of their losses denied would need to be known. Because it is difficult to predict this number of taxpayers 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 $5 million.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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