



## Bill Analysis

Author: Senate Committee on Budget and Fiscal Review      Sponsor:      Bill Number: SB 175  
Related Bills: See Legislative History      Amended: June 22, 2024

### SUBJECT

Net Operating Loss (NOL) Suspension and Credit Limitation Trigger; Credit Ordering and Credits Reducing Tax Below Tentative Minimum Tax (TMT); and Annual Refundable Credit Election and Other Conforming Amendments

### SUMMARY

This bill would do the following:

#### *Provision No. 1 - NOL Suspension and Credit Limitation Trigger*

Sections 7, 9, 11, and 13 of the bill, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), would provide that if the Director of the Department of Finance (Director) determines that there is sufficient general fund money, then the suspension of the NOL deduction and the credit limitation, as provided in SB 167 (Senate Committee on Budget and Fiscal Review, Chapter 34, Statutes of 2024), would not apply for the 2025 or 2026 taxable year.

#### *Provision No. 2 – Credit Ordering and Credits Reducing Tax Below TMT*

Sections 6 and 10 of the bill, for taxable years beginning on or after January 1, 2027, under the PITL and the CTL, would add the annual refundable credit to the order of credits allowed to be taken against net tax or tax, as applicable, and to reduce the tax amount owed below the TMT.

#### *Provision No. 3 - Annual Refundable Credit Election and Other Conforming Amendments*

Sections 7, 8, 11, 12, 15, and 16 of the bill, under the PITL and CTL, would allow taxpayers subject to the \$5 million credit limitation under SB 167 (Senate Committee on Budget and Fiscal Review, Chapter 34, Statutes of 2024) the option for taxable years beginning on or after January 1, 2024, and before January 1, 2027, to elect to receive a refund of those limited tax credits in taxable years after the limitation becomes inoperative, as specified; would provide specific treatment for any refundable motion picture tax credit made under the one-time election; and would make other conforming amendments.

**RECOMMENDATION**

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

**SUMMARY OF AMENDMENTS**

The June 22, 2024, amendments removed intent language relating to the Budget Act of 2023 and replaced it with the provisions discussed in this analysis.

This is the Franchise Tax Board’s (FTB) first analysis of the bill and only addresses the provisions that would impact the FTB.

**REASON FOR THE BILL**

The reason for the bill is to make various statutory changes relating to implementation of the Budget Act of 2024.

*Economic Impact – Summary Revenue Table (\$ in Billions)*

<b>Fiscal Year</b>	<b>2025-2026</b>	<b>2026-2027</b>	<b>2027-2028</b>
Provision No. 1	N/A	N/A	N/A
Provisions No. 2 and 3	\$0	\$0	\$1.0

**ANALYSIS**

**Analysis Provision No. 1:**

*NOL Suspension and Credit Limitation Trigger (Sections 7, 9, 11, and 13 of the Bill)*

Provision 1 would provide that for taxable years beginning on or after January 1, 2025, and before January 1, 2027, pursuant to legislation in the annual Budget Act, the NOL suspension and the credit limitation would not apply, if, by May 14, 2025, and by May 14, 2026, respectively, the Director determines that general fund money over the multiyear forecast is sufficient without considering the revenue impact of the NOL suspension and credit limitation, then the NOL suspension and the credit limitation would not apply for the taxable year.

Note that any amount included in an election pursuant to Section 6902.5, relating to an irrevocable election to apply credit amounts under Sections 17053.85, 17053.95, 17053.98, 17053.98.1, 23685, 23695, 23698, 23698, or 23698.1 against qualified sales and use tax, as defined in Section 6902.5, are not included in the \$5 million limitation.

In addition, for taxpayers that make the one-time refundable election under the film credit, this provision would allow the refundable credits over the \$5 million limitation in the first taxable year that the limitation is not operative. For taxpayers that make the one-time refundable election under the film credit and the annual refundable credit election, this provision would limit the total credit amount allowed under both elections to be the amount allowed under the film credit 4.0.

#### Effective/Operative Date

As a provision within a bill providing for an appropriation relating to the Budget Bill, this provision would be effective immediately upon enactment. The NOL suspension and credit limitation would be specifically inoperative for taxable years beginning on or after January 1, 2025, and before January 1, 2026, or for taxable years beginning on or after January 1, 2026, and before January 1, 2027, if the Director determines general fund money is sufficient, as described above, and legislation in the annual Budget Act is enacted not to apply those provisions. The provision related to the elections would be operative for taxable years beginning on or after January 1, 2024.

#### *Federal/State Law*

##### *Federal Law*

No comparable provision in federal law.

##### *State Law*

#### NOL Suspension

For taxable years beginning on or after January 1, 2024, and before January 1, 2027, the following taxpayers are subject to an NOL suspension:

- Under the PITL, those with modified adjusted gross income (AGI), as shown on the federal tax return for the same taxable year without taking into consideration the NOL deduction, or net business income, which means income from a trade or business, whether conducted by the taxpayer or by a pass-through entity (PTE), partnership or S corporation, income from rental activity, and income attributable to a farming business, of \$1 million or more.
- Under the CTL, those with income subject to tax of \$1 million or more.

In addition, the NOL carryover period is extended by one year for NOLs incurred in taxable year 2025, two years for NOLs incurred in taxable year 2024, and three years for NOLs incurred in taxable years beginning before 2024.

### Credit Limitations

For taxable years beginning on or after January 1, 2024, and before January 1, 2027, the PITL and CTL:

- Limit the amount of business credits to \$5 million.
- Exclude various credits from the credit limitation.
- Increase the carryforward period for credits subject to the limitation by the number of taxable years the credit or the carryover of a credit was not allowed.
- Specify that the election under Revenue and Taxation Code (RTC) section 6902.5 to apply film credits against the sales and use tax would not be subject to this provision's credit limitation.

For purposes of the PITL credit limitation, the \$5 million credit limit applies to business credits, which specifically excludes the credits relating to earned income, young child, foster youth, household and dependent care, elective tax under the Small Business Relief Act, adoption costs, renters, personal exemption, joint custody head of household and for care of dependent parent, senior head of household, excess contributions of unemployment compensation, and the Low Income Housing Credit (LHC). Business credits, as limited, are required to be applied against the tax due before the credits excluded from the definition of business credits. For purposes of the CTL credit limitation, the \$5 million credit limit applies to all credits, except the LHC.

### *Implementation Considerations*

None noted.

### *Technical Considerations*

None noted.

### *Policy Considerations*

None noted.

### **LEGISLATIVE HISTORY**

No legislation similar to this bill has been identified.

### **PROGRAM BACKGROUND**

None noted.

### **OTHER STATES' INFORMATON**

None noted.

**FISCAL IMPACT**

This provision would not significantly impact FTB's costs.

**ECONOMIC IMPACT***Revenue Estimate*

This provision as amended June 22, 2024, would not change the way income or franchise tax is calculated under the RTC. This does not account for changes in employment, personal income, or gross state product that could result from this provision or for the net final payment method of accrual.

**LEGAL IMPACT**

None noted.

**EQUITY IMPACT**

None noted.

**Analysis Provision No. 2:***Credit Ordering and Credits Reducing Tax Below TMT (Sections 6 and 10 of the Bill)*

Under the PITL, this provision would specify that for taxable years beginning on or after January 1, 2027, the annual refundable credit would be placed after the motion picture credit 4.0 and before the credits relating to refunds pursuant to the Unemployment Insurance Code and tax withholding. Under the CTL, this provision would specify that for taxable years beginning on or after January 1, 2027, the annual refundable credit would be placed after the motion picture credit 4.0, and before credits for tax withholding.

This provision, under the PITL and CTL, for taxable years beginning on or after January 1, 2027, would also allow the annual refundable credit to reduce the amount of regular tax below the TMT.

*Effective/Operative Date*

As a provision within a bill providing for appropriations relating to the Budget Bill, this provision would be effective immediately upon enactment. The amendments specifying the ordering for the annual refundable credit would be specifically operative for taxable years beginning on or after January 1, 2027, and the amendment allowing the annual refundable credit to reduce the tax below TMT would be specifically operative for taxable years beginning on or after January 1, 2027.

*Federal/State Law**Federal Law*

Individuals are subject to the alternative minimum tax (AMT), which is imposed on the amount of the TMT over the regular tax. General business credits allowed for any taxable year are limited to the excess of a taxpayer's net income tax over the greater of: (1) the TMT for the taxable year, or (2) 25% of the amount of the taxpayer's net regular tax that exceeds \$25,000. In addition, the empowerment zone employment credit, and other specified credits have various rules for limiting the usage of credits.

For taxable years beginning on or after January 1, 2018, and before January 1, 2023, the corporate AMT was repealed, and changes were made to the AMT credit provisions. For taxable years beginning on or after January 1, 2023, the 15% corporate AMT is imposed on the adjusted financial statement income of large corporations. Large corporations are those with an average annual adjusted financial statement income that exceeds \$1 billion.

*State Law*

Current state law provides a general rule that tax credits imposed under the PITL and CTL may not reduce tax below TMT, unless specifically provided otherwise. There are numerous credits listed that are allowed to reduce the tax below the TMT, such as solar energy credits, the College Access Tax Credit, the California Competes Tax Credit, and motion picture credits.

The TMT for individuals is 7%, for general corporations is 6.65%, and for financial corporations is 8.65% of the excess Alternative Minimum Taxable Income of the exemption amount. Corporations with valid S corporation elections are not subject to the AMT. The TMT is compared to the taxpayer's regular tax. For purposes of this comparison, regular tax is defined as the personal income tax, corporation franchise tax, the corporation income tax, or the tax on the unrelated business income of an exempt corporation before the reduction for any credits. If the TMT exceeds the regular tax, the difference is the AMT. Without considering tax credits, the taxpayer is effectively required to pay the higher of the TMT or the regular tax for the taxable year.

*Implementation Considerations*

None noted.

*Technical Considerations*

None noted.

*Policy Considerations*

None noted.

**LEGISLATIVE HISTORY**

SB 132 (Senate Committee on Budget and Fiscal Review, Chapter 132, Statutes of 2023) amongst other items, under the PITL and CTL, for taxable years beginning on or after January 1, 2025, added the motion picture credit 4.0 to the order of credits allowed to be taken against tax, and allows the motion picture credit 3.0, the credit for certified studio construction project, and the motion picture credit 4.0 to reduce tax below the TMT.

SB 113 (Senate Committee on Budget and Fiscal Review, Chapter 3, Statutes of 2021) amongst other items, under the PITL, for taxable years beginning on or after January 1, 2021, and before January 1, 2025, allows the PTE elective tax credit to reduce tax below TMT, made changes to the order of credits allowed to be taken against the net tax, and made other nonsubstantive technical changes.

**PROGRAM BACKGROUND**

None noted.

**OTHER STATES' INFORMATION**

None noted.

**FISCAL IMPACT (Provisions 2 and 3)**

FTB's estimated costs to implement these provisions are approximately \$30,000 for fiscal year 2024-2025; \$18,000 for fiscal year 2025-2026; \$1,130,000 for fiscal year 2026-2027; \$1,260,000 for fiscal year 2027-2028; and \$280,000 for each fiscal year from 2028-2029 through 2032-2033.

**ECONOMIC IMPACT (Provisions 2 and 3)**

*Revenue Estimate*

*(\$ in Billions)*

<b>Fiscal Year</b>	<b>2025-2026</b>	<b>2026-2027</b>	<b>2027-2028</b>
Provisions No. 2 and 3	\$0	\$0	\$1.0

*Revenue Discussion*

These provisions would result in a revenue impact. In accordance with the bill provisions, staff defers to the Department of Finance to determine the revenue impact of these provisions.

**LEGAL IMPACT**

None noted.

**EQUITY IMPACT**

None noted.

***Analysis Provision No. 3:***

*Annual Refundable Credit Election and Other Conforming Amendments (Sections 7, 8, 11, 12, 15, and 16 of the Bill)*

For taxable years beginning on or after January 1, 2024, and before January 1, 2027, a taxpayer would be able to elect to receive an annual refundable credit amount of qualified credits in each taxable year of the refundable period. The annual refundable credit amount would be allowed as a credit for the taxable year, and the excess, if any, would be credited against other amounts due, if any, and then the balance, if any, would be refunded to the taxpayer during the refundable period.

No portion of the annual refundable credit amount could be assigned to another taxpayer. Any refundable credit amount would be paid from the Tax Relief and Refund Account.

For purposes of this provision, the following definitions would apply:

- “Annual refundable credit amount” would mean 20% of the credit amount for the taxable year.
- “Credit amount” would mean the amount of the qualified credits that would have otherwise been available to reduce the taxpayer’s tax in the taxable year of the election but for the \$5 million credit limitation. In the case of:
  - A PTE, the “credit amount” would refer to the pro rata share or distributive share of the credit passed through to the partner or shareholder of the qualified taxpayer. For these purposes, the term “pass-through entity” would mean any partnership, S corporation, or limited liability company treated as a partnership.
  - An assigned credit, the “credit amount” would refer to the credit amount that was assigned to the taxpayer.



- Taxpayers required to be included in a combined report under Section 25101 or 25110, or taxpayers authorized to be included in a combined report under Section 25101.15, the “credit amount” would refer to the credit amount of all members of the combined report.
- “Qualified credits” would mean the credits subject to the \$5 million credit limitation for taxable years beginning on or after January 1, 2024, and before January 1, 2027.
- “Refundable period” would mean the first five consecutive taxable years beginning the third taxable year after the taxable year that the taxpayer makes an election under this provision.

The taxpayer would be able to make an election for any of the taxable years beginning on or after January 1, 2024, and before January 1, 2027. Each election would be irrevocable and would be required to be made on an original, timely filed return for the taxable year that the election is being made in the form and manner as prescribed by the FTB.

Adjustments made by the FTB to the annual refundable credit amount would be treated as a mathematical error appearing on the return and would be assessed in the same manner as provided by Section 19051. This would include, but would not be limited to, the following:

- A valid election as required under this provision was not made.
- The FTB determines that the credit amount overstatements in any taxable year resulted in an overstatement in any carryover amount or an overstatement of any refundable credit amount.
- The FTB determines that the credit amount was overstated as a result of any subsequent adjustment in the amount of net tax, including, but not limited to, an audit adjustment or claim for refund.

This provision would also make other conforming amendments, such as:

- Clarifying that any amount of refundable motion picture credit, related to the one-time election under Section 17053.98.1 or Section 23698.1, over the \$5 million limitation would be allowed in the first taxable year for which the \$5 million limitation is no longer operative.
- Clarifying if a taxpayer makes both the one-time refundable motion picture election and the annual refundable credit election, then the total amount of refundable credits allowed pursuant to both elections could not exceed the allowed film and motion picture credit.

The FTB may prescribe regulations necessary or appropriate to carry out the purposes of this provision. This provision would exempt FTB's rules, guidelines, or procedures from the requirements of the Administrative Procedure Act.

This provision would remain in effect only until December 1, 2034, and as of that date would be repealed.

#### Effective/Operative Date

As a provision within a bill providing for an appropriation relating to the Budget Bill, this provision would be effective immediately upon enactment. The annual refundable credit election would be specifically operative for taxable years beginning on or after January 1, 2024, and before January 1, 2027.

#### Federal/State Law

No comparable provision in federal or state law.

#### Implementation Considerations

None noted.

#### Technical Considerations

None noted.

#### Policy Considerations

None noted.

### **LEGISLATIVE HISTORY**

SB 167 (Senate Committee on Budget and Fiscal Review, Chapter 34, Statutes of 2024), among other things, suspended the NOL deduction unless the taxpayer's net business income or modified AGI under the PITL was less than \$1 million, or the taxpayer's income subject to tax under the CTL was less than \$1 million, for taxable years 2024, 2025, and 2026, and extended the NOL carryover period for deductions disallowed under the bill. In addition, under the PITL and CTL, SB 167 limited the use of business tax credits to \$5 million for taxable years 2024, 2025, and 2026, and extended the credit carryover period for credits disallowed under the bill. SB 167 also contains language expressing the Legislature's intent to allow taxpayers subject to the credit limitation under Sections 15 and 33 of SB 167 the option to elect to receive a refund of those limited tax credits, as specified, and that the refundable credit amount can be adjusted by the FTB if the amount is determined to be overstated.

SB 132 (Senate Committee on Budget and Fiscal Review, Chapter 56, Statutes of 2023), among other things, for taxable years beginning on or after January 1, 2025, under the PITL and CTL, allows a motion picture credit 4.0 to a qualified taxpayer for qualified expenditures for the production of a qualified motion picture in California. A qualified taxpayer can make a one-time irrevocable election to be paid a refund of the credit at a discounted rate, paid ratably over 5 years.

SB 113 (Senate Committee on Budget and Fiscal Review, Chapter 3, Statutes of 2022) amongst other things, under the PITL and CTL, repealed the suspension of the NOL deduction and the business entity tax credit limitation for the 2022 taxable year.

AB 85 (Assembly Committee on Budget, Chapter 8, Statutes of 2020), under the PITL and CTL, among other provisions, limited the use of business tax credits to \$5 million for the 2020 through 2022 taxable years, and extended the credit carryover period for credits it disallowed.

#### **PROGRAM BACKGROUND**

None noted.

#### **OTHER STATES' INFORMATON**

None Noted.

#### **LEGAL IMPACT**

None noted.

#### **EQUITY IMPACT**

None noted.

#### **APPOINTMENTS (All Provisions)**

None noted.

#### **SUPPORT/OPPOSITION (All Provisions)**

Senate Floor Analysis, June 26, 2024.

*Support:*

None on file.

*Opposition:*

None on file.

**ARGUMENTS (All Provisions)**

Assembly Floor Analysis, June 25, 2024.

*Proponents:*

None on file.

*Opponents:*

None on file.

**LEGISLATIVE CONTACT**

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