STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Ta

Sponsor:

Bill Number: AB 702

Related Bills: See Legislative History

Introduced: February 14, 2025

SUBJECT

Gross Income Exclusion for Interest Income Theft

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), for taxable years beginning on or after January 1, 2026, exclude from the gross income qualified investment interest income generated by a qualified taxpayer.

RECOMMENDATION

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

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to prevent hardship for taxpayers who experienced theft of funds from financial accounts.

ANALYSIS

This bill, under the PITL, for taxable years beginning on or after January 1, 2026, would exclude from the gross income qualified investment interest generated by a qualified taxpayer.

This bill defines the following term:

> "Qualified investment interest" means interest income that a taxpayer generates on an investment during the taxable year and, without the qualified taxpayer's consent, and against the qualified taxpayer's will, is stolen, sold, or otherwise transferred during the taxable year so that the interest income is no longer under the possession or control of the taxpayer.

This bill provides that no deduction would be allowed with respect to any amount that a taxpayer excludes from gross income under this section.

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, 2026.

Federal/State Law

Federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Types of income currently excluded include amounts received as a gift or inheritance, certain compensation for injuries and sickness, educational assistance programs, foster care payments, interest received on certain state or federal obligations, and qualified scholarships.

Federal law provides for deductions of losses arising out of fire, storm, shipwreck or theft. Federal laws provide that theft losses are deductible in the year the taxpayer discovers the loss. State law generally conforms to federal law for deduction of theft losses. Under federal law, for tax years beginning after December 1, 2017, and before January 1, 2026, individual casualty and theft losses are suspended except for such losses incurred in a federally declared disaster. California law does not conform to the suspension.

Implementation Considerations

The Franchise Tax Board (FTB) has identified the following implementation consideration and is available to work with the author's office to resolve this and other considerations that may be identified.

This bill uses the following undefined term, "investment." The absence of a definition could lead to taxpayer confusion and without a clear definition the application of this bill could be broad. For clarity, the author may wish to amend the bill to define this term.

To ease administration of this exclusion, the author may wish to amend the bill to add the following language: "The taxpayer shall provide, upon request by the FTB, supporting documentation verifying qualified investment interest.

Technical Considerations

For consistency of terminology, clarity, and to ensure that the program can be administered as intended, the following changes are recommended:

- In Section 17133.2 (b), the term "qualified taxpayer" should be replaced with "taxpayer."
- In Section 17133.2(c), the phrase "A deduction shall not be allowed with respect to any amount that a taxpayer excludes from income pursuant to this section" should be replaced with "A deduction shall not be allowed under this part for any amount that is excluded from gross income under this section."

To clarify that the exclusion would apply to interest income realized by the taxpayer, it is recommended to replace "that a taxpayer generates" with "received by or credited to the taxpayer."

Policy Considerations

This bill does not limit the dollar amount that may be excluded from gross income. Income exclusions that could potentially be costly are sometimes limited on a per-taxpayer basis. If this is contrary to the author's intent, the author may wish to amend the bill to provide a provision limiting the amount or providing a phase out provision based on a taxpayer's income.

This bill does not provide a sunset date, which would generally allow periodic review of the effectiveness of the tax law change. If this is contrary to the author's intent, the author may wish to amend the bill.

LEGISLATIVE HISTORY

AB 232 (Calderon and Gipson, 2025/2026), under the PITL, would allow homeowners to establish a catastrophe savings account (CSA) to pay for insurance deductibles and other uninsured losses resulting from a Governor-declared emergency or expenses to incorporate property-level wildfire mitigation efforts. This bill would provide both a deduction for amounts contributed by an individual homeowner to a CSA and a gross income exclusion for interest amounts earned by a CSA for taxable years beginning on or after January 1, 2026, and before January 1, 2031. This bill is currently with the Assembly Committee on Revenue and Taxation and was last amended on April 11, 2025.

AB 490 (Tangipa, 2025/2026), under the PITL, would allow an above-the-line deduction for interest paid by a taxpayer on a qualified motor vehicle loan for each taxable year beginning on or after January 1, 2026, and before January 1, 2031. This bill was referred to the Assembly Committee on Revenue and Taxation, and following first hearing, was referred to the Assembly Revenue and Taxation suspense file.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

The FTB'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 Estimate

This proposal would allow a taxpayer to exclude from gross income any amount of qualified investment interest income generated by a taxpayer from an investment that is stolen, sold, or otherwise transferred without the taxpayer's consent and against the taxpayer's will. To determine the magnitude of the potential impact to the General Fund, both the frequency of investment theft and the dollar amounts of interest income related to these investments must be known. Because it is difficult to predict the frequency of investment theft as well as the amount of interest income related to the theft, the revenue impact to the General Fund is unknown.

However, it is assumed that for every $10 million in qualified investment interest income generated, and applying an average tax rate of 6.7 percent, the estimated revenue loss would be approximately $670,000.

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.

LEGAL IMPACT

None noted.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov