April 8, 2013

TO: Members, Assembly Revenue and Taxation Committee

SUBJECT: AB 769 (SKINNER): TAXATION: DEDUCTIONS: NET OPERATING LOSS CARRYBACKS
OPPOSE/JOB KILLER – AS INTRODUCED FEBRUARY 21, 2013
SET FOR HEARING – APRIL 15, 2013

The California Chamber of Commerce and the above organizations must regretfully **OPPOSE AB 769 (Skinner)** as a **JOB KILLER**, which proposes to repeal the two-year carryback provision for the Net Operating Loss (NOL) deduction.

The NOL Deduction Resolves an Inequity in the Net Income Tax Structure.
California businesses of all sizes and structures report and pay tax on their net income based on an arbitrary 12-month reporting period. An NOL occurs when a taxpayer's business expenses exceed their revenue during that arbitrary 12-month reporting period. The NOL deduction allows a business taxpayer to offset current losses against future taxable income (carryover) or prior liabilities (carryback).

The purpose of an NOL deduction is to recognize that the "business cycle" (the period of time from capital investment to profit recognition on that investment) does not align with the government's 12-month timeframe for filing taxes. For some businesses, that cycle is relatively short, for others it can be very long. Without an NOL deduction, the income tax fails to adequately match investment expense with revenue earned on that investment essentially penalizing capital investment. The NOL therefore serves to ensure that taxable income more closely resembles the actual net income of the business enterprise. NOLs are not economic incentive tools; they are integral to a fairly applied net income tax regime.

Without the NOL Deduction, Two Business Can Have Same Profits and Losses But Different Tax Liability.

	Year 1	**Year 2**	**Year 3**	**Year 4***	**Totals**
Al's Autos					
Profits	+$1,000	+$1,000	+$1,000	+$1,000	$4,000
Losses	-$300	-$300	-$300	-$300	-$1,200
Taxes	$700 x 10% = 70	$700 x 10% = 70	$700 x 10% = 70	$700 x 10% = 70	**$280**
Barb's Builders					
Profits	$0	$0	$0	+$4,000	$4000
Losses	-$400	-$400	-$400	$0	-$1,200
Taxes	$0	$0	$0	$4,000 x 10% = $400	**$400 (Barb owes more)**

*4-year timeframe and 10% tax rate arbitrary — chosen for illustration purposes only.

The NOL Carryback is Particularly Important for Keeping Struggling Businesses Afloat.
The NOL carryback allows a company experiencing losses to amend the prior two years' tax returns to offset tax liability going backward in time, making cash immediately available for paying bills and employee salaries, and for making business investments. This makes the carryback a life-line to businesses struggling to deal with the current downturn, and who, without it, might not be able to last long enough to take advantage of the carry-forward deduction. The carryback deduction is particularly critical for new businesses that struggle with profitability during their initial years, and need help to get off the ground.

California is not alone in seeing the value of an NOL carryback deduction **-** the federal government also provides one, and in fact, recently expanded the carryback period from two to five years for small businesses, and will allow *all* businesses to carry back their 2009 losses for five years. **AB 769** would cut off this life-line for California businesses at a time when California's economic growth continues to lag.

Unreliable Tax Environments Deter Employers from Investing in California.
Predictability is as important to employers as overall tax burden to economic investment. Employers cannot adequately evaluate potential costs if they cannot predict future tax liabilities. The NOL carryback was included in the 2008 budget package to help partially offset the harm to California businesses caused by a two-year suspension of the NOL deduction. The promise of a positive change in the near future helped demonstrate that California is committed to keeping employers in the state, despite the hit to businesses that year. Unfortunately, California again suspended the NOL deduction for the 2010 and 2011 tax years. In contrast, the federal government has extended their carryback provision from two to five years.

AB 769 not only reverses the 2008 compromise just as the taxpayer's benefit from that agreement begins to materialize, it reinforces with employers that California's taxing environment is unpredictable. Lack of predictability adds to risk, increased risk adds to overall cost of doing business, further hindering California's economic recovery.

For these reasons and more, we respectfully **OPPOSE AB 769 (Skinner)** as a **JOB KILLER** and ask you to vote **NO** when it is heard before the Assembly Revenue and Taxation Committee.

Sincerely,

California Chamber of Commerce
California Asian Pacific Chamber of Commerce
California Bankers Association
California Grocers Association
California Healthcare Institute
California Taxpayers Association
Council on State Taxation

cc: The Honorable Nancy Skinner
Brian Putler, Office of the Governor
Oksana Jaffe, Assembly Revenue and Taxation Committee
Julia King, Assembly Republican Caucus
District Offices, Assembly Revenue and Taxation Committee Members

JM:ks