September 1, 2009

Hon. Edmund G. Brown Jr.
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Krystal Paris
Initiative Coordinator

Dear Attorney General Brown:

Pursuant to Elections Code Section 9005, we have reviewed the proposed initiative on corporate taxes (A.G. File No. 09-0020).

PROPOSAL

The measure repeals three business income tax provisions passed by the Legislature and approved by the Governor as part of the September 2008 and February 2009 budget agreements. Under current law, the provisions will take effect starting in tax years 2010 or 2011.

- ***Net Operating Loss Carrybacks.*** Firms that lose money in one year are allowed to deduct these losses against income reported in subsequent years. Beginning in 2011, a new provision goes into effect, allowing firms to deduct losses against profits reported in either of the two *previous* years. For example, a firm that turns a profit (and pays taxes) in 2010 but loses money in 2011 will be able to deduct its 2011 losses against its 2010 profit and file an amended return for 2010. This measure repeals the carryback provision.
- ***Credit Sharing Among Member Firms of a Unitary Group.*** The credit-sharing provision will allow a firm with more credits than it can use (because its available credits exceed its total tax bill) to transfer its unused credits to another firm in the same unitary (or combined) group starting in 2010. Through 2009, credits are restricted to the firm that earns them. This measure repeals the ability to share credits.

- ***Optional Single Sales Factor.*** If a firm operates in California and at least one other state, its California taxable income is defined as its national income multiplied by a weighted average of the fractions of its national property, payroll, and sales that are attributable to California. Currently, the weights on the property and payroll factors are 0.25 and the weight on the sales factor is 0.5. Starting in 2011, a firm will be allowed to decide each year whether to use this formula or an alternate formula that uses only the sales factor. Under this option, its California taxable income would be equal to its national income multiplied by the ratio of its California sales to its national sales. This measure repeals the option to use the alternative sales factor formula.

FISCAL EFFECTS

By repealing the three provisions, this measure would increase the taxes paid by businesses. The Franchise Tax Board (FTB) estimates that the combined net impact of repealing the provisions would increase General Fund tax revenues by $80 million in 2009-10, $600 million in 2010-11, $1.7 billion in 2011-12 (first full-year effect), and increasing amounts thereafter.

Although the FTB's net estimate takes into account interactions among the three provisions involved, it does not incorporate various behavioral effects that might take place in response to the measure. For example, some firms that would expect to benefit from the optional single sales factor may cut back their planned California operations in the absence of this option. Certain evidence suggests that a higher sales factor can promote job growth. Similarly, the loss of the credit-sharing provision may make it harder for firms with actual or expected excess credits to raise capital, so such firms may experience a reduction in their taxable activity. The effect on behavior from removing these provisions is difficult to estimate. Any potential adverse effects on the economy and state and local tax revenues would be offset to some extent by the benefits of the public services or reductions in other taxes that would be funded by the revenue from repealing these provisions.

Summary of Fiscal Effect

The measure would have the following major fiscal effect:

- Annual state revenue increase from business taxes of about $1.7 billion when fully phased in, beginning in 2011-12.

Sincerely,

Mac Taylor
Legislative Analyst

Michael C. Genest
Director of Finance