September 29, 2010

Overview of
Proposition 24

L E G I S L A T I V E A N A L Y S T ’ S O
F F I C E

Presented to:

Joint Hearing of Senate and Assembly
Committees
On Revenue and Taxation

September 29, 2010

Overview

•
Three provisions of California’s laws for
taxing businesses
changed recently as part of 2008 and 2009
state budget
agreements between the Legislature and the
Governor. The

three provisions are those dealing with:
•
The use of operating losses.
•
The taxation of the income of multistate businesses.
•
Tax credit sharing.
•
Under current law, all of these recent changes will be in effect
by the 2011 tax year.
•
Proposition 24 would repeal business tax law changes passed
in 2008 and 2009 in the three areas listed above. In general, this
would return business taxes to what they were under prior law.
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September 29, 2010

Changes to the Use of Operating Losses

Prior Law Current Law
Law if
Proposition 24
Passes

Carrybacks. Business losses cannot
Carrybacks. Business losses can be used to get refunds Same as
be used to get refunds of taxes of taxes paid in the prior two years. prior law.
previously paid.

Carryforwards. Businesses can
Carryforwards. Businesses can use losses to offset in-Same as
use losses to offset income in the come in the 20 years following the loss. prior law.
ten years following the loss.

•
Under federal and state tax laws, in a year when a business has
more deductible expenses than income, the business has a net
operating loss (NOL).
•
Under current state law, a business with an NOL in one year
generally can "carry forward" the losses to reduce its taxes when
it makes a profit in the 20 years following the loss.
•
Under current state law, a business with

an NOL in one year
generally will be able to “carry back” the losses to reduce its
taxes for the two previous years, if those years were profi table.

•
These mechanisms have been put in place in part to recognize
that business income or expenses can vary significantly from
year to year.

•
Example: a business that had profits and paid taxes in 2009
but has a loss in 2011 may deduct its 2011 NOL against its 2009
taxable income under current law. The business would fi le an
amended tax return for 2009 and receive a tax refund.

•
If Proposition 24 passes, carryback and carryforward provisions
would return to what they were under prior law.

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September 29, 2010

Changes to Taxation of the Income of Multistate Businesses

Prior Law Current Law
Law if
Proposition 24
Passes
A single formula determines the Most multistate businesses will choose every year between Same as
level of a multistate business' two options to determine the level of income that California prior law.
income that California taxes based can tax: (1) the formula under prior law, or (2) a formula
on the business' sales, property, that considers only the business' sales in California relative
and payroll in California. to its national sales.

•
Businesses often operate in many states. To determine how
much of the income of a multistate business is taxed by the
state, California law has used a "three-factor" formula that
considers how concentrated a business'

property, payroll, and
sales are in California compared to the rest of the nation.

•
Starting in 2011 under current law, most multistate businesses will
be able to choose each year between two formulas to set the level
of income California can tax. A business' two options will be:

•
The three-factor formula.

•
The new "single sales factor" formula, which is based only on
the portion of the business' overall national sales that are in
California.

•
If Proposition 24 passes, taxation of the income of multistate
businesses would continue to be based on the three-factor
formula.

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September 29, 2010

Changes to Rules for Tax Credit Sharing

Prior Law Current Law
Law if
Proposition 24
Passes
Tax credits given to a business entity can
Tax credits given to a business entity can
be Same as
only reduce that entity’s taxes. That
entity used to reduce the taxes of other
entities in the prior law.
cannot share its tax credits with entities
in same group of related businesses.
the same group of businesses.

•
Tax credits can reduce a business’ taxes.
If a business has
credits which exceed the amount of taxes
it owes in a given year,
it will have unused credits that typically
can be carried forward to
be used in future years.
•
Many business organizations consist of a
group of business
entities. This is called a “unitary group”
if it meets certain
conditions, such as operating jointly or

operating under the
same management.
•
Tax credits are given to individual business entities—not unitary
groups.
•
A law approved by the Legislature and the Governor in 2008
allows a business with available tax credits to transfer unused
tax credits to another business in the same unitary group.
Shared credits can be used to reduce taxes in 2010 and later
years.
•
If Proposition 24 passes, tax credits would not be able to be
transferred to other businesses within a unitary group.
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September 29, 2010

Summary of Proposition 24’s Effects

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If Proposition 24 passes, the three business tax provisions discussed in this handout will return to what they were before 2008 and 2009 law changes. As a result:

- A business will be less able to deduct losses in one year against income in other years.
- A multistate business will have its California income determined by a calculation using three factors.
- A business will not be able to share tax credits with related businesses.
- If Proposition 24 does not pass, the three business tax provisions that were recently changed will not be affected.

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September 29, 2010

Increased State Revenues

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This proposition would increase state General Fund revenues
by increasing the taxes paid by businesses.
•
By 2012-13, state revenues would increase by an estimated
$1.3 billion annually. There would be smaller increases as the
provisions of Proposition 24 are phased in during 2010-11 and
2011-12.
•
More than one-half of these estimated increased taxes would
be paid by multistate businesses as a result of the elimination
of the single sales factor option.
•
Under the formulas of Proposition 98, a significant part of
Proposition 24’s revenue increases would be allocated to
schools and community colleges.
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