



Date: June 11, 2020

To: Members, California State Legislature

From: Peter Blocker, Vice President of Policy

Subject: **OPPOSITION to AB 85 (Assembly Budget Committee), as amended on June 10, 2020 and SB 114 (Senate Budget and Fiscal Review Committee), as amended on June 10, 2020**

The California Taxpayers Association and the organizations listed below oppose AB 85 and SB 114, which would raise taxes by \$9.2 billion on businesses during the worst economic downturn since the Great Depression. These budget provisions would suspend the net operating loss deduction, as well as limit the utilization of business tax incentives and credits, including the Research and Development Tax Credit.

A survey released June 3 by the California Public Policy Institute of California found that **60 percent of likely voters OPPOSE including higher taxes in the state budget.**

California is facing an unprecedented, sudden economic collapse. Unemployment is at a record high. For the first time in decades, businesses of all sizes are severely impacted, including some large corporate taxpayers that are unprofitable. Many small businesses will struggle to reopen – and to stay open afterward. These combined forces are having an immediate impact on tax revenue in the current and upcoming fiscal years.

The Department of Finance forecasts that California will see a General Fund revenue shortfall of \$41 billion in fiscal years 2019-20 and 2020-21. However, there seems to be disagreement among the available models about the size of California's budget shortfall. For example, the Legislative Analyst's Office "[Spring Fiscal Outlook](#)" projects a much more hopeful fiscal scenario, specifically:

Revenues and Other Resources Available Lower by \$26 Billion to \$39 Billion. Under both recession scenarios, our revenue estimates are tens of billions of dollars lower than the Governor's budget estimates in January. In the U-shaped scenario, revenues and other resources (specifically, the Special Fund for Economic Uncertainties [SFEU]) are lower by \$26 billion from 2018-19 to 2020-21. In the L-shaped scenario, resources are lower by \$39 billion across the same years. These revenue losses account for federal reimbursements from the state and federal disaster declaration ... and the estimated SFEU balance in the Governor's budget.

There is no playbook for forecasting this economy. Given the unprecedented level of uncertainty, the \$9.2 billion tax increase contained in these bills should be reconsidered. Now is not the time to pick winners and losers in a frail economy, while so many Californians are hurting.

While accurately predicting the economic impact is impossible, one thing remains certain: California businesses are the only engine that can pull the state out of recession and get Californians back on their feet. Just as California employers played a pivotal role in creating the large reserves that are helping the state avoid billions of dollars in budget cuts, they will be critical to the state's recovery. Now is not the time to put economic hurdles in front of these struggling home-state businesses.

The corporate tax provisions outlined in these bills would prolong the recession, extend California's fiscal crisis, lower future tax receipts, and necessitate future budget cuts from schools and critical services.

Times like these are when tax credits and incentives have the most beneficial impact. Tax credits and incentives can be powerful tools to promote economic expansion, encourage rehiring, incentivize businesses to locate in the state, and help businesses regain economic footing.

These bills contain two major, retroactive taxes that amount to a \$9.2 billion tax increase on California businesses from fiscal years 2020-21 through 2022-23:

1) Suspension of the Net Operating Loss Deduction ("NOL")

These bills propose to suspend the net operating loss deduction for tax years 2020, 2021, and 2022, for "medium and large businesses." This would place California out of step with every other state in the country that levies a corporate income tax. While other states are trying to jump-start job creators, these provisions would do the opposite to California employers.

Under California law, businesses may carry forward their NOLs to deduct against taxable income in future years. NOLs incurred in 2013 through 2018 can be carried back to the prior two years to deduct against taxable income. However, NOLs incurred in 2019 and after cannot be carried back to previous years. The proposed NOL suspension would prevent businesses from applying their NOLs to deduct against taxable income during taxable years 2020 through 2022. Further, this suspension would be retroactive to January 1, 2020, causing a major disruption for businesses that already made planning decisions for 2020.

A net operating loss occurs when a business' expenses exceed its income within a single tax year. Broadly speaking, the two parts of the NOL deduction make it possible for businesses to manage their losses by allowing them to offset or deduct one tax year's losses from another tax year's profits. The purpose is to resolve an inequity in our tax structure that arises because businesses experience losses and profits according to timeframes or cycles that do not necessarily coincide with government tax filing deadlines that are arbitrary to begin with.

Reducing or eliminating deductions translates into a direct tax increase for businesses. Since employers make business plans over the long term, unexpected changes to investment incentives can have drastic consequences, even for medium and large businesses – operations that could emerge from the pandemic as small businesses, if they survive at all. Merely proposing such changes creates instability and unpredictability that chill investment and growth. Now more than ever, California needs to encourage employers to invest here and get us back on the road to recovery.

Suspending NOLs would compound the economic harm already facing so many businesses because of COVID-19. Many businesses that have had long-term growth cycles are, for the first time in decades – or ever – expecting to operate at a loss in 2020 because of COVID-19. As businesses hopefully begin to recover in 2021 and later, it may take years for them to restore what was lost in 2020. Maintaining NOLs is vital to ensuring that once businesses regain profitability, they can deduct losses resulting from COVID-19 in 2021 and 2022, allowing for a quick economic recovery.

NOLs, by definition, help businesses that are struggling with losses. Without the ability to deduct these losses against future income, taxpayers would appear to be profitable when in fact they are not. The pandemic has placed many more businesses in this category. The state should not take the air out of this desperately needed assistance.

2) Limitation of Business Tax Incentives, Including the Research & Development Tax Credit ("R&D"), Hiring Tax Credit & Motion Picture Production Incentives

These bills seek to raise taxes by prohibiting businesses from claiming more than \$5 million in tax credits per tax year in 2020, 2021, and 2022.

R&D is the most important activity taking place on this planet. As California businesses begin to develop a vaccine, treatment, testing and new technologies to respond to COVID-19, they should be supported by all of us. The state (and the country) will not return to normal and move past this pandemic without R&D, and we should be doing everything possible to make sure this activity happens here in California. These bills penalize these efforts.

The R&D credit supports labor expenses, supplies and materials (except equipment) used for research performed in California. R&D involves highly compensated research jobs that boost personal income, sales and property tax revenue for the state. This investment also creates jobs that benefit California's universities and colleges.

Through years of trial-and-error research and long days spent turning ideas into groundbreaking consumer products, California companies led the world into a technological age. Thanks to California-grown technology, it is possible for people around the world to continue earning income while working from home, and California's state government has been able to continue serving the public during a pandemic that requires physical distancing. The policy decisions made today will determine where this sort of progress takes place tomorrow.

The provisions to limit the R&D tax credit come at a particularly dire time. This would set back the ability for a taxpayer to claim credits under a typical five-year business plan over those years. Research projects are long-term investments that can take years from conception to fruition. A temporary deferral would dampen this wellspring of innovation and jobs.

Our ability to remain competitive as a state, and to retain our position as the world's fifth-largest economy, depends on a strong state R&D tax credit.

Additionally, these bills would limit:

- **Incentives for Hiring California Workers.** These bills would limit the utilization of hiring credits, including the Hiring Credit (RTC Section 23621), Hiring Credit for Employees in Designated Census Tracts (RTC Section 23626), and the GO-Biz Hiring Tax Credit (RTC Section 23689). Hiring credits encourage businesses to increase employment in the state. At a time when unemployment is at record levels, hiring credits are a powerful tool to encourage employers to begin putting Californians back to work once the economy begins to recover.
- **Incentives for Filming Motion Pictures & Television in California.** These bills limit the utilization of the qualified expenditures for Production of Qualified Motion Pictures (RTC Sections 23685, 23695, and 23698). These tax credits promote and incentivize the filming and production of film and television projects within the state of California. In a 2018 study conducted by Film L.A., California was ranked No. 4 in terms of top 100 domestic films produced by location. In 2013, California was tied for No. 1 and Georgia was tied for No. 4. However, Georgia leapfrogged California and now ranks No. 2, demonstrating how effective that state has been in attracting productions through its various incentives. By limiting these tax credits, California is pushing taxpayers and the industry to move operations out of state, at a time when the focus should be on keeping and increasing the number of working Californians to help in the economic recovery. Every production creates jobs for writers, camera operators, wardrobe specialists, caterers, office staff and many other workers – and Californians need these jobs.

We urge the Legislature to support California's workers and its economy by not acting hastily and imposing harmful, unpopular tax increases that create barriers to recovery. For these reasons, the California Taxpayers Association and the organizations below respectfully oppose these bills.

California Taxpayers Association
Acclamation Insurance Management Services
Advanced Medical Technology Association
Agricultural Council of California
Airlines for America
Alliance for Automobile Innovation

Allied Managed Care
Almond Alliance of California
American Property Casualty Insurance Association
Associated General Contractors
Association of California Egg Farmers

Bay Area Council
BFBA, LLP
Biocom
Biotechnology Innovation Association (BIO)
Business Software Alliance (BSA)
California Association of Wheat Growers
California Bean Shippers Association
California Beer & Beverage Distributors
California Building Industry Association
California Cable & Telecommunications
Association
California Farm Bureau Federation
California Fuels and Convenience Alliance
California Grain & Feed Association
California Hispanic Chamber of Commerce
California League of Food Producers
California Life Sciences Association
California Manufacturers & Technology
Association
California Pear Growers Association
California Restaurant Association
California Retailers Association
California Seed Association
California State Floral Association
California Warehouse Association

Cellular Telecommunications Industry Association
CompTIA
Contra Costa Taxpayers Association
Council on State Taxation
Family Business Association of California
Fountain Valley Chamber of Commerce
Greater San Fernando Valley Chamber of
Commerce
Kern County Taxpayers Association
Orange County Business Council
Orange County Taxpayers Association
Pacific Coast Rendering Association
Pacific Egg & Poultry Association
Pharmaceutical Research and Manufacturers of
America (PhRMA)
San Gabriel Valley Economic Partnership
Silicon Valley Leadership Group
Solano County Taxpayers Association
Sutter County Taxpayers Association
TechNet
West Coast Lumber & Building Material
Association
Western Growers Association
Western States Petroleum Association