



MULTISTATE INCOME/FRANCHISE TAX

## California bill suspends net operating losses, limits certain tax credits, and clarifies apportionment

### Tax Alert

## Overview

On June 13, 2024, the California legislature passed Senate Bill 167 ([SB 167](#)). If enacted, SB 167 provides for a three-year suspension of net operating losses (“NOLs”) under the California Personal Income Tax and Corporation Tax, a three-year cap on the use of business incentive tax credits to offset no more than \$5 million of tax per year, and retroactive application of the Franchise Tax Board’s (“FTB”) [Legal Ruling 2006-1](#) (“Legal Ruling”) issued on April 28, 2006, with respect to the treatment of apportionment factors attributable to income exempt from California Corporation Tax Law.

This Tax Alert summarizes some of the relevant provisions in SB 167.

## Suspension of NOLs

- SB 167 adds California Revenue and Taxation Code (“CRTC”) section 17276.24 under Personal Income Tax Law and section 24416.24 under Corporation Tax Law, both of which temporarily disallow the NOL deduction for taxable years beginning on or after January 1, 2024, and before January 1, 2027.
- SB 167 allows for an extension of the NOL carryover period under Section 172 of the Internal Revenue Code for any NOLs that were suspended under SB 167. The carryover period under Section 172 of the IRC is extended as follows:
  - By one year, for losses incurred in taxable years beginning on or after January 1, 2025, and before January 1, 2026;
  - By two years, for losses incurred in taxable years beginning on or after January 1, 2024, and before January 1, 2025; and
  - By three years, for losses incurred in taxable years beginning before January 1, 2024.
- Taxpayers with less than \$1 million subject to California tax are exempt from the NOL suspension.

## Limitation of business tax credits

- SB 167 adds CRTC section 17039.4 under Personal Income Tax Law and section 23036.4 under Corporation Tax Law, both of which limit the use of business tax credits to offset no more than \$5 million of California income tax for each taxable year beginning on or after January 1, 2024, and before January 1, 2027.
- Sections 17039.4 and 23036.4 provide that for taxpayers required to be included in a combined report, the \$5 million limitation is applied on an aggregate basis. Therefore, the total of all credits allowable (including carryovers of any credit) by all members of the combined report shall not reduce the aggregate amount of tax of all members of the combined report by more than \$5 million.
- Additionally, under both CRTC sections 17039.4 and 23036.4, any credit that is disallowed shall remain a credit carryover amount and the carryover period shall be increased by the number of taxable years the credit, or any portion thereof, was not allowed.
- The Low-Income Housing Tax Credit and the Pass-Through Entity Elective Tax Credit are exempt from the \$5 million credit limitation.
- SB 167 also stated the Legislature's intent to enact legislation allowing taxpayers to utilize their credits after the limitation period ends by electing to receive a refund of those tax credits.
- SB 167 also adds that California's Administrative Procedure Act ("APA") does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or issued by the FTB pursuant to CRTC sections 17039.4 and 23036.4.

## Apportionment provisions and FTB rulemaking authority

- SB 167 adds CRTC section 25128.9, which provides that any transaction or activity, to the extent that it generates income or loss "not included in 'net income'" subject to apportionment, is excluded from the California apportionment formulas under the Corporation Tax Law. "Not included in 'net income,'" is defined as "income from transactions and activities that is not included in net income subject to apportionment for any reason, including, but not limited to, exclusion, deduction, exemption, elimination, or nonrecognition."
- Section 25128.9 also declares the Legislature's intent to apply the Legal Ruling with respect to apportionment factors attributable to income of taxpayers subject to California's Corporation Tax. Further, section 25128.9 declares the Legislature's intent that this section does not constitute a change in, but is declaratory of, existing law. This Legal Ruling was called into significant doubt by recent decisions issued by the Office of Tax Appeal, and this legislation reaffirms its applicability.
- Section 25128.9 also grants the FTB broad rulemaking authority. Section 25128.9 provides that the FTB may adopt regulations that are necessary or appropriate to carry out the purpose of this section (related to apportionment) without the application of the APA to any regulation, standard, criterion, procedure, determination, rule, notice, guideline, or any other guidance issued by the FTB pursuant to section 25128.9.
- Notably, section 25128.9 applies retroactively to taxable years beginning before, on, or after the effective date of the act adding section 25128.9.

## Considerations

Taxpayers should consider the impact of SB 167 on their California income tax obligations should it be enacted. Taxpayers should reassess implications for their NOL utilization planning due to the temporary suspension and consider

the extended NOL carryover periods. Taxpayers should also evaluate taxable income and plan for the \$5 million cap on tax credit usage, and also consider potential changes to accounting methods and elections in light of this proposed change. Additionally, taxpayers should be on the lookout for new regulations and guidance to address compliance requirements and update tax planning in accordance with California's existing apportionment rules. Taxpayers with claims for refund or original return positions contrary to Legal Ruling 2006-1 should consider procedural options for resolving any tax controversies with the FTB. We will continue to monitor future developments related to these matters.

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