

YES ON 24 THE TAX FAIRNESS ACT

Frequently Asked Questions: Proposition 24

What does Proposition 24 do?

Prop 24 ensures that a few big corporations pay their fair share of state taxes. It repeals three special corporate tax loopholes that were handed out to big corporations without any requirements to create or keep a single job:

Loss-Carryback: Corporations will get refunds for taxes paid in past years by writing off new losses.

Sharing Tax Credits: Corporations that get tax credits for things like research and development or alternative energy will be able to cash those credits in on reducing taxes on profits that have nothing to do with those efforts.

Single Sales Factor: Corporations that do business in other states will have two different formulas for computing their taxes and will be allowed to use whichever formula would require them to pay less in taxes in California.

Why should I support Proposition 24?

California is facing another massive state budget shortfall. Big corporations need to pay their fair share. Prop 24, the Tax Fairness Act, ends \$1.3 billion a year in special corporate tax loopholes that don't require the creation or protection of one single California job. During the recent state budget disaster, Sacramento politicians and big corporations cut deals behind closed doors that raised your taxes by \$18 billion, but gave big corporations a \$1.3 billion tax break each year. If these loopholes are not closed before they go into effect in 2011, they will cut corporate taxes in California by nearly 15 percent and not create or save a single new job in California.

Paid for by Yes on 24, the Tax Fairness Act sponsored by the California Teachers Association. Major funding by California Teachers Association Issues PAC and Yes on Prop 1A and 1B, Repay and Protect Our Schools.

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What will funds secured from Proposition 24 be used for?

Prop 24 will help keep the Legislature from making even deeper cuts in public education, health care and public safety. During last year's budget disaster, the Legislature made \$30 billion in cuts that resulted in 16,000 teacher layoffs, college tuition hikes for students and put 6,500 prisoners back on the street, but gave corporations \$1.3 billion in future tax breaks.

Will Proposition 24 cost California jobs?

No. Closing these loopholes will not cost California jobs because companies won't lose anything they already have. These tax loopholes don't take effect until 2011. There is no requirement that the corporations that receive the tax breaks must create or protect jobs in California. These corporations would still be allowed to outsource jobs to other countries and states.

In 2009 alone, the big corporations that are paying hundreds of thousands of dollars to defeat Proposition 25 laid off over 100,000 employees. In the past few years, those same corporations paid their CEOs \$8.5 BILLION.

What types of corporations get these tax breaks?

These tax breaks unfairly benefit less than two percent of California's businesses and they are the state's wealthiest multi-state and multi-national corporations. 87 percent of one of the tax breaks goes to .03 percent of the California's corporations with gross incomes of more than \$1 billion. Six multi-state corporations would get average tax cuts of \$23.5 million each. Voting YES on Prop 24 ends these unfair tax breaks before they take effect. That's tax fairness.

Will Proposition 24 hurt California's small businesses.

No. 98 percent of California's businesses, especially small businesses, would get virtually no benefit from the tax breaks.


Who supports Proposition 24?

A broad coalition of community, consumer, taxpayer and labor unions, including the California Teachers Association (CTA), California Nurses Association (CNA), CALPIRG, Consumer Federation of California, Congress of California Seniors, League of Women Voters of California, California Tax Reform Association concerned with tax fairness. The campaign is just beginning and outreach and support continues to grow.

How do I get involved?

Go to www.PayTheirFairShare.com to get more information, download an endorsement form and see other ways to support this common-sense measure.

YES ON 24



THE TAX FAIRNESS ACT

- ❖ **Proposition 24**, the Tax Fairness Act, ends \$1.3 billion in special tax loopholes for big corporations that don't require the creation or protection of one single job in California.
 - During the recent state budget disaster, Sacramento politicians and big corporations cut a deal behind closed doors to raise your taxes, and give themselves huge tax breaks.
 - This deal with legislators included \$18 billion in tax hikes for California taxpayers and \$1.3 billion in tax breaks a year for the state's biggest and wealthiest corporations.
 - These same corporations made no guarantees that a single job would be created or saved to get this handout. The corporations would get these tax breaks, but could still send jobs overseas or to other states.
 - **Prop 24** stops a small number of big corporations from using tax credits they didn't earn to reduce their taxes, shift current losses to past tax years to get additional tax refunds, and lets businesses choose the way they calculate their taxes in order to reduce what they pay.

- ❖ **Proposition 24** ensures that a few big corporations pay their fair share of state taxes at a time when state is making drastic budget cuts to public schools, health care and public safety.
 - These unfair corporate tax loopholes put an even bigger burden on the average individual taxpayer. When corporations pay less, you pay more.
 - **Prop 24** will help keep the Legislature from making even deeper cuts in public education, health care and public safety. During last year's budget disaster, the Legislature made \$30 billion in cuts that resulted in laying off 16,000 teachers, raising college tuition by more than 30 percent, layoffs, and putting 6,500 prisoners back on the street, but gave corporations \$1.3 billion a year in tax breaks.

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❖ **Proposition 24** doesn't hurt California's small businesses, it ensures tax fairness so big corporations have to play by the same rules as the rest of us.

- **Prop 24** will end tax loopholes that unfairly benefit less than 2 percent of California's businesses that are wealthy, multi-state and multi-national corporations.
- 98 percent of California's businesses, especially small businesses, would get virtually no benefit from the tax breaks.
- The big corporations that are paying to defeat **Prop 24** and keep these loopholes have paid their CEOs over \$8.5 billion in the last few years, and made over \$65 billion in profits last year, while at the same time laying off over 100,000 workers.

Dan Morain: Secret tax break now faces union effort to end it

Share

By Dan Morain, Senior editor

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As dead-of-night deals go, the one granting corporations a tax break worth \$900 million annually was a stunner.

Gov. Arnold Schwarzenegger and legislators convened no hearings and heard no testimony, except for that offered by corporate lobbyists in private. It was part of a megadeal in February 2009 intended to "solve" last year's budget crisis.

The crisis, of course, has taken a turn for the worse, but the tax cut remains, set to take effect next year.

California's budget is in disrepair for many reasons. But the story of the 2009 tax breaks and two others approved in 2008 and the effort to unravel them helps illustrate the mess we're in.

After being approved in secret, the tax breaks are being challenged in a very California manner. Leaders of the California Teachers Association, fearing more cuts to schools, are offering to reshape tax law, sponsoring Proposition 24, an initiative this November to overturn the tax cuts.

The union that represents most public school teachers in California has shown an ability to spend tens of millions on campaigns to get its way. This time, the teachers are facing a formidable coalition of corporations and business organizations.

Corporate consultants will play on voters' anxiety over the economy. The union will seek to channel voter anger at corporations. The theme will be all too familiar by Election Day, playing out in the race for governor between billionaire Meg Whitman and career politician Jerry Brown, for U.S. Senate between the ex-Hewlett Packard CEO Carly Fiorina and incumbent Sen. Barbara Boxer, and in other initiatives.

"Unemployed people and stagnant business don't generate revenue, or fund programs that our companies and Democrats care about," said Tim Valderrama, California executive of TechNet, a trade group of technology companies leading the opposition.

David Sanchez, president of the California Teachers Association, decries funding cuts to schools and scoffs at corporate claims: "They'll move to another state? Please. There is no evidence that this (initiative) is going to drive business away."

Sanchez seeks to frame the issue as one of fairness. California's tax burden has shifted to individuals. Corporate taxes accounted for 15.4 percent of the general revenue collected by California in 1976. By 2014, after the breaks take hold, corporations would account for 9.4 percent of general tax collections, the nonpartisan Legislative Analyst's Office says.

The breaks would be sweet. Say a company has two good years. It pays taxes, and the state spends the money. Then, say the company loses money. It could use that loss to get a refund on the taxes it paid in the two previous years. That break, amounting to \$500 million annually, would force the state to essentially grant retroactive tax refunds.

A few corporations stand to reap huge windfalls. One of the breaks would give companies a direct say over how much they pay in state taxes.

They could base their tax bill on a formula that takes into account their property, payroll and sales within California. Alternatively, they could rely on sales within the state. Their choice, whichever costs less. Corporations could save \$900 million a year. But the Franchise Tax Board says nine companies could receive benefits of \$20 million or more each, \$180 million total, each year.

Another tax break would permit companies and their subsidiaries to share tax credits among themselves. This would save companies \$300 million annually in California taxes. But six corporations would gain more than \$10 million a year, each, according to the Franchise Tax Board.

In other words, about 15 companies (there could be overlap among beneficiaries) stand to reap \$240 million combined.

"The dollar savings for a small number of companies is nothing short of stunning," said Jean Ross, who has been tracking California's budget for two decades and directs the liberal Center for Budget Policy.

The amount that companies pay in taxes is confidential. But the companies giving initial funding to defeat the initiative have their reasons, likely that they would be hurt if voters were to approve Proposition 24.

Initial donations of \$100,000 have come from Walt Disney, Hewlett-Packard, Cisco, Abbott Laboratories, Amgen, Johnson & Johnson, Fox Group, Time-Warner, CBS, and General Electric, owners of NBC-Universal.

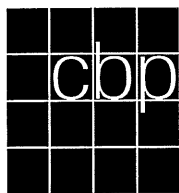
Politicians tweak the tax code to stimulate jobs. Businesses decide to expand or to move for a variety of reasons. A \$20 million a year tax break would be significant. There are other factors, too, like the quality of public services, funded by taxes paid by individuals and corporations.

Herbert W. Boyer was a professor of biochemistry at UC San Francisco when he co-founded what became the iconic biotech firm, Genentech. That was in 1976, when corporate taxes accounted for 15 percent of the state's revenue.

Roche Holdings, the Swiss-based pharmaceutical giant, last year bought Genentech for \$46.8 billion. The Roche subsidiary gave \$100,000 to defeat the initiative to roll back corporate tax breaks.

Lawmakers draw flawed breaks behind closed doors. The teachers union steps in to abolish them. Tech giants that previously benefited from public spending prepare to spend big money to cut off a potential source of state revenue. Our public finance system is in a sad state of disrepair.

Read more: http://www.sacbee.com/2010/07/08/2875631/dan-morain-secret-tax-break-now.html#mi_rss=Opinion#ixzz0t6zSSmce



TO HAVE AND HAVE NOT

In September 2008, the Legislature passed a spending plan that included \$11.4 billion in reductions to nearly all areas of the state budget. In February 2009, the Legislature made an additional \$6.8 billion in cuts to 2008-09 spending and passed a budget for 2009-10 that included \$8.6 billion in spending reductions. In light of the magnitude of California's fiscal problems, one might expect that there would be no "winners." In fact, both the September 2008 and February 2009 budget agreements created some very big winners – a very small number of corporations that will receive tens of millions of dollars per year in tax breaks as a result of changes made to California's corporate tax laws.

Three's Company

The two budget agreements made three changes to California's corporate income tax laws that mark a significant departure from longstanding policy, including:

- **Elective single sales factor apportionment.** Allowing corporations to choose between two methods for determining the share of their profits that would be taxed in California. Traditionally, California has used a three-factor formula that takes into account the share of a corporation's property, payroll, and sales that are located in California. Under the change made in February 2009, corporations could choose to be taxed solely on the share of their sales that occur in California.
- **Tax credit sharing.** Allowing corporations to transfer tax credits among a family – or combined reporting group – of related corporations. Traditionally, only the corporation earning a tax credit could claim that tax credit.
- **Net operating loss carrybacks.** Allowing corporations to claim refunds on taxes already paid by claiming tax deductions for net operating losses (NOLs). California previously allowed businesses to "carry forward" and deduct operating losses against future income. The recent change allows businesses to "carry back" operating loss deductions and claim refunds against prior years' taxes.

No public hearings were held, and no public testimony was provided, on either the September 2008 or the February 2009 changes that will, at full implementation, result in a loss of \$2.0 billion per year, and potentially as much as \$2.5 billion, in corporate tax revenues, an amount equal to nearly one-quarter of the income tax dollars currently paid by California corporations (Figure 1).¹

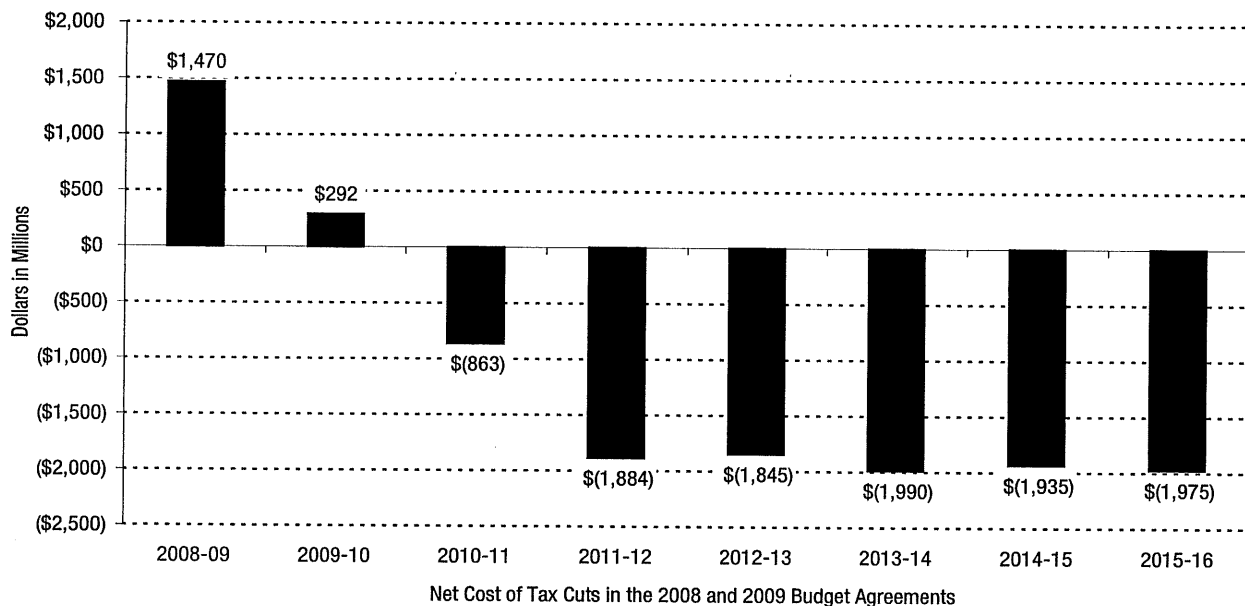
The Color of Money

The three proposals will result in very large tax cuts for relatively few California businesses:

- Nine corporations will receive tax cuts averaging \$33.1 million each in 2013-14 due to the adoption of elective single sales factor apportionment.²
- Eighty percent of the benefits of single sales factor apportionment will go to the 0.1 percent of California corporations with gross incomes over \$1 billion.
- Six corporations will receive tax cuts averaging \$23.5 million each in 2013-14 from the adoption of credit sharing.
- Eighty-seven percent of the benefits from credit sharing will go to the 0.03 percent of California corporations with gross incomes over \$1 billion.

Moreover, some firms will likely benefit from more than one of these provisions. For example, a firm could benefit from both single sales factor apportionment and credit sharing. In addition

Figure 1: 2008 and 2009 Tax Deals Will Lose \$8.7 Billion Over Eight Years
Losses Will Continue Permanently



Note: Includes temporary business tax cuts enacted in February 2009.
Source: Franchise Tax Board

to these major permanent changes, the February 2009 budget agreement included two temporary tax cuts for businesses that take effect immediately: a tax credit for motion picture production activities and a tax credit for businesses that increase employment. A total of \$400 million worth of hiring credits are available and \$500 million in motion picture tax credits are available over five years.

As You Like It

California's corporate income tax applies to the income generated by business activities that are attributable to California. For corporations that only do business within the state, determining the income that is subject to state tax is straightforward. For multi-state and multi-national corporations, determining the income that is attributable to California is more complex. Traditionally, states have used a formula based on three equally weighted factors to apportion income among states for tax purposes. The traditional formula apportioned income based on the percentage of a corporation's total property, payroll, and sales within a given state. California used this approach prior to 1993. In 1993, California shifted to a formula that gave twice as much weight to the fraction of sales that occur within the state. This approach is called "double weighting" the sales factor.

AB 15xxx (Krekorian), enacted in February 2009, allows corporations to base their corporate income tax payments solely

on the share of their sales that occur within California. This change would take effect beginning January 1, 2011. AB 15xxx allows corporations to choose, or elect, to use the new method or to continue to use the existing formula. This policy, known as elective single sales factor apportionment, allows firms to calculate their taxes both ways and choose the method that offers the lowest tax bill. The shift to elective single sales factor apportionment will cost the state an estimated \$260 million in 2010-11, with the cost quickly rising to \$1 billion per year in 2014-15. Some forecasts suggest that when fully implemented, single sales factor apportionment will cost the state \$1.5 billion per year in lost revenues.³

State law prohibits disclosure of the names of the firms that would benefit from the state's adoption of single sales factor apportionment. Since there were no public hearings on AB 15xxx, there is no public record of the measure's supporters. In the past, supporters of proposals to more heavily weight the sales factor have included Apple, Inc.; Genentech, Inc.; Intel; Paramount Pictures; The Walt Disney Corporation; and Warner Brothers Entertainment, Inc., among others.⁴

Estimates prepared by the Franchise Tax Board show that the benefits of single sales factor apportionment would be concentrated among a very few, very large corporations:

- Nine corporations – 0.001 percent of all California corporations – would receive tax cuts of more than \$20

million – nearly one-third of the total cost of single sales factor apportionment (Figure 2). Tax cuts for the “lucky nine” would average \$33.1 million per firm in 2013-14. An additional 13 corporations’ tax bills would be reduced by \$10 million to \$20 million in 2013-14.

- Single sales factor apportionment will overwhelmingly benefit California’s largest corporations; 80 percent of the benefits will go to companies with gross receipts in excess of \$1 billion. These beneficiaries account for just 0.1 percent of all California corporations (Figure 3). Ninety-five percent of the benefits will go to 0.3 percent of the state’s corporations.
- Elective single sales factor apportionment will result in 2013-14 tax cuts of \$1 million or more for 152 corporations – 0.02 percent of all California corporations – at a \$768 million cost to the state.
- Twenty-eight utility corporations will receive 2013-14 tax cuts averaging \$1.7 million per firm (Figure 4). This is significant since these firms are tied to California by virtue of the service they produce and the customers they serve.

All in the Family

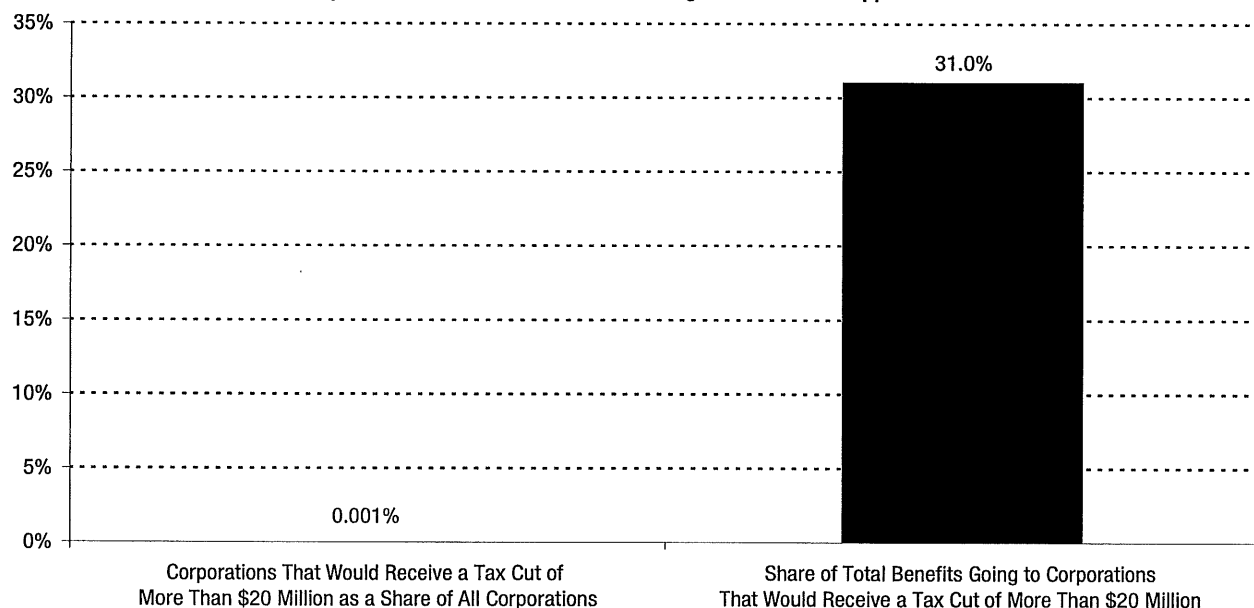
California traditionally restricted the use of tax credits to the taxpayer that actually engaged in the activity that generated the credit. AB 1452 (Committee on Budget), enacted as part of the September 2008 budget agreement, allows taxpayers to share

credits with other corporations that are related – members of the same combined reporting group in tax terminology.⁵ This change would apply to credits earned on or after July 1, 2008 or credits earned in prior years that are eligible to be carried forward into years beginning on or after July 1, 2008, but shared credits could not be used to reduce a corporation’s taxes until 2010. This provision will cost the state \$80 million in lost revenues in 2009-10, and \$270 million in 2010-11, and the cost would increase to an estimated \$385 million in 2015-16.

Similar to the benefits from single sales factor apportionment, the benefits of credit sharing would largely go to a very few, very large corporations:

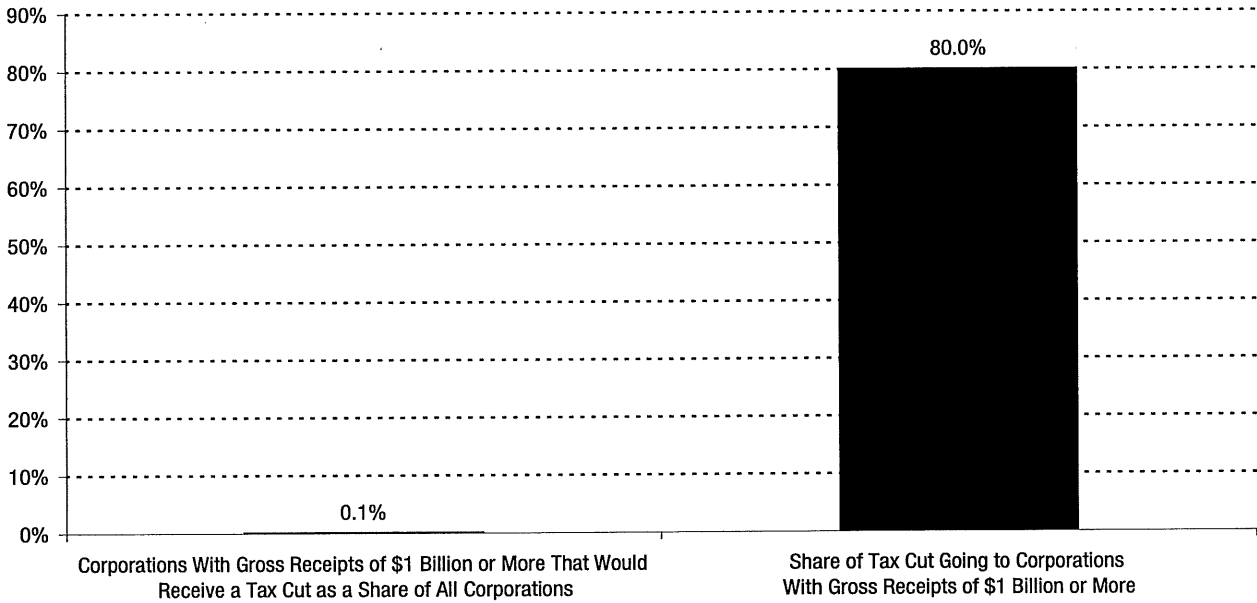
- Six corporations – 0.001 percent of all California corporations – would receive tax breaks of more than \$10 million from credit sharing in 2013-14. These tax breaks, which would average \$23.5 million per firm, will cost the state a total of \$141 million. An additional eight corporations would receive tax breaks of \$5 million to \$10 million per firm at a cost of \$54 million in 2013-14 (Figure 5).
- Credit sharing will also benefit California’s largest corporations. Nearly nine out of every 10 dollars (87 percent) of revenues lost due to this provision will go to 229 firms – 0.03 percent of California corporations – that have gross receipts in excess of \$1 billion (Figure 6).

Figure 2: Nine Corporations Would Receive Tax Cuts of More Than \$20 Million Each — Nearly One-Third of the Benefits From Single Sales Factor Apportionment



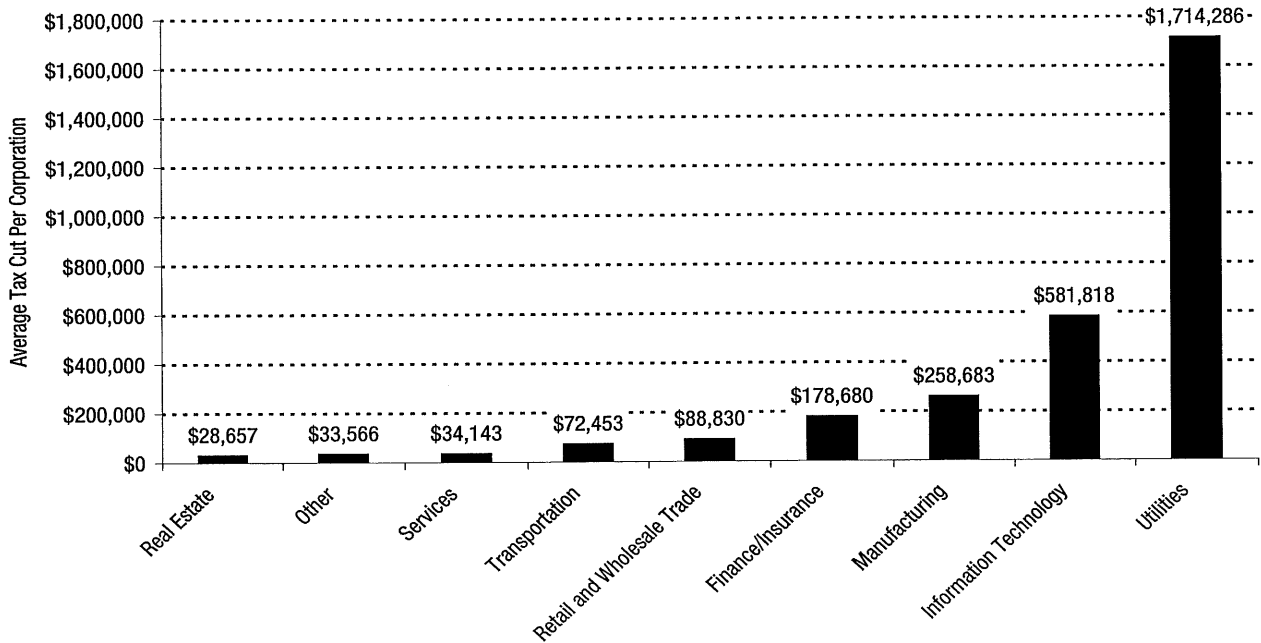
Source: Franchise Tax Board

Figure 3: 80 Percent of the Benefits From Single Sales Factor Apportionment Would Go to 0.1 Percent of Corporations



Source: Franchise Tax Board

Figure 4: The Utility Sector Would Receive the Largest Benefit Per Corporation From Single Sales Factor Apportionment



Source: Franchise Tax Board

**Figure 5: Fourteen Corporations Would Receive Tax Cuts of \$5 Million or More Each —
Totaling More Than Half of the Benefits From Credit Sharing**

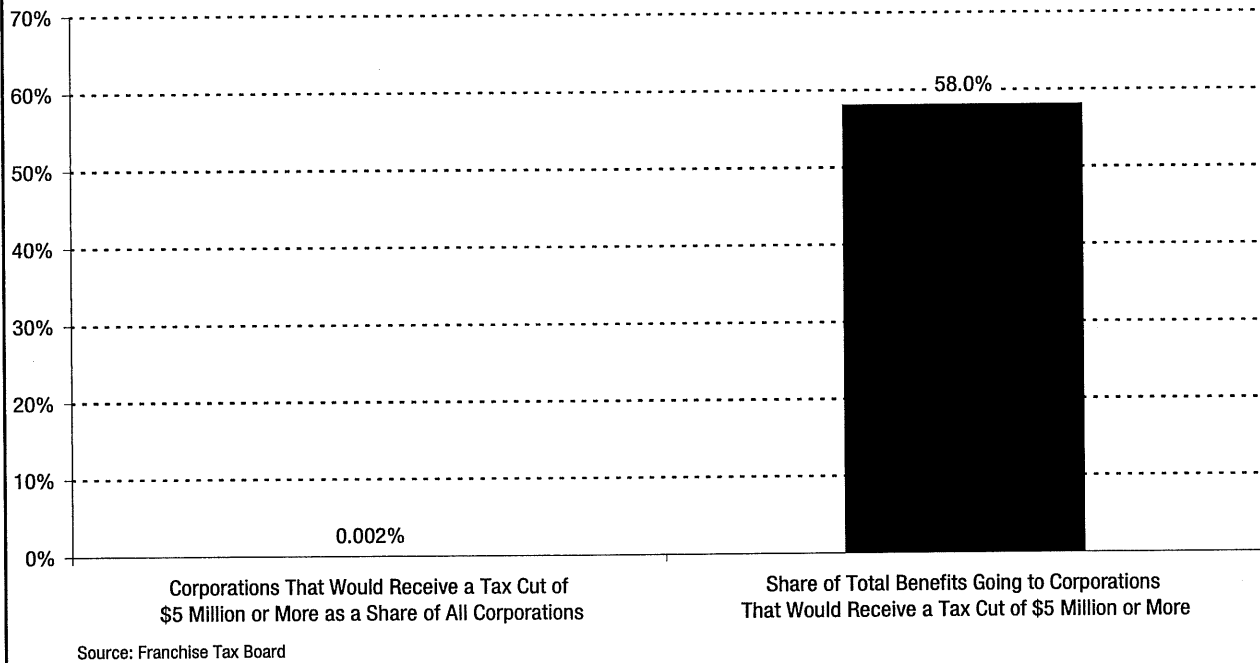
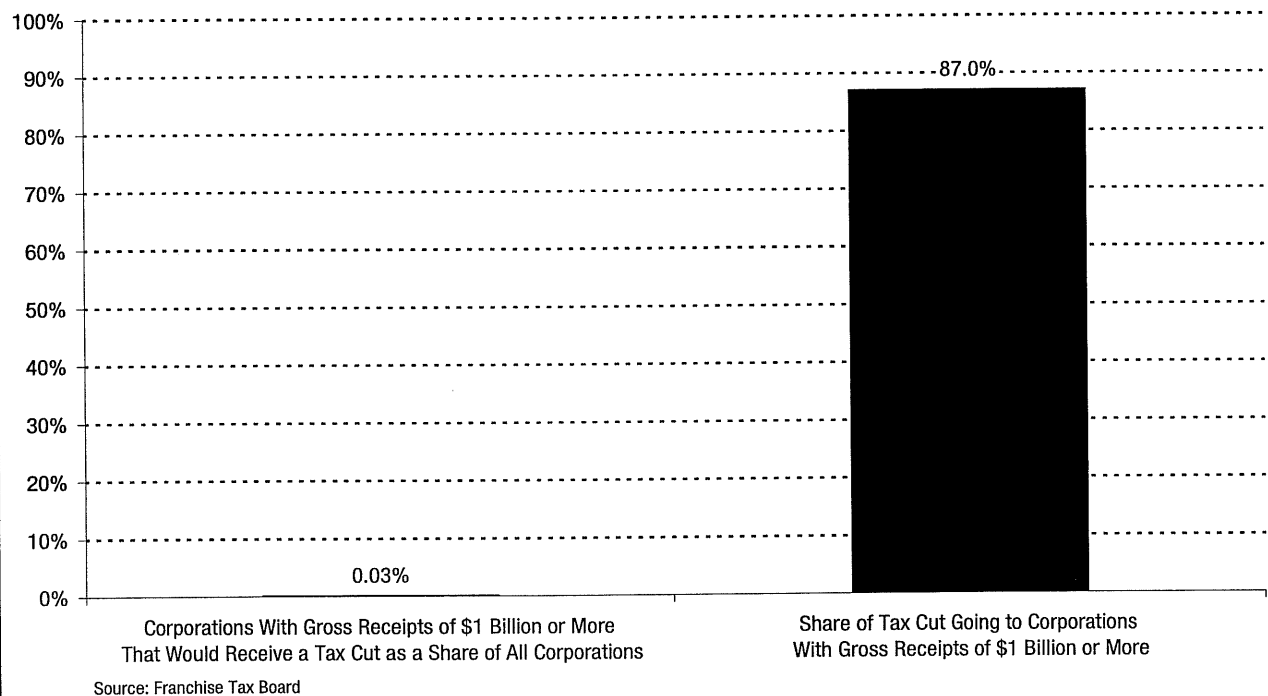


Figure 6: 87 Percent of the Benefits From Credit Sharing Would Go To 0.03 Percent of Corporations



Take It Back

Tax laws allow businesses that lose money to “carry forward” their losses and claim them as a tax deduction in a future year when the business becomes profitable. The September 2008 budget agreement suspended large businesses’ ability to claim deductions for operating losses in 2008 and 2009 and then extended the period that losses incurred in 2008 or prior years could be carried forward for use in future years; lengthened the period that losses earned in 2008 or later could be carried forward; and allowed losses to be carried back and used as a deduction in a prior year beginning in 2011.⁶ While federal law previously allowed businesses to “carry back” their losses, the September change marks a major and very costly shift in California’s tax policy.

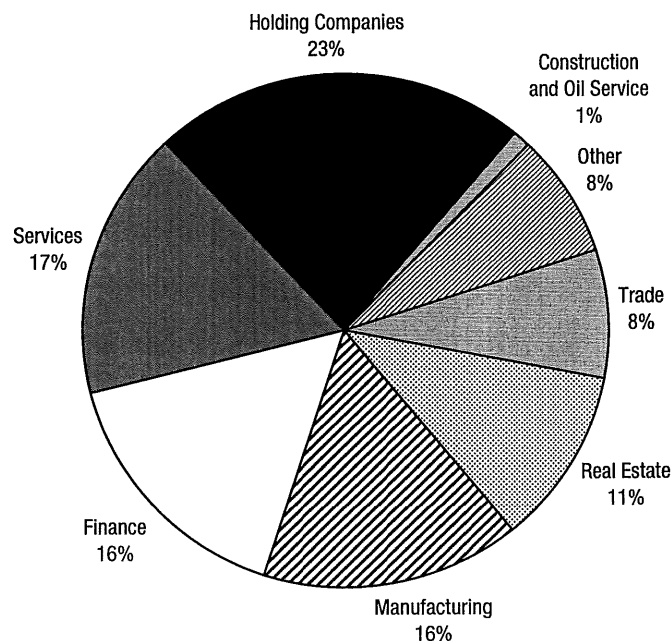
Loss carryback deductions are particularly noteworthy in the context of California’s persistent budget problems. When businesses carry back a net operating loss deduction, they file an amended tax return and claim a refund of taxes paid in a prior year – taxes that were already collected and taxes that were spent in the year that they were owed. The magnitude of the revenue loss attributable to loss carrybacks – over \$500 million at full implementation – is significant. The impact of loss carrybacks is particularly troublesome because businesses are likely to claim them in bad budget years based on profits

earned and taxes in during previous good economic times. Thus, allowing businesses to claim tax deductions for prior years will likely exacerbate California’s persistent budget problems. Loss carryback deductions will cost the state an estimated \$30 million in 2010-11, with the cost rising to \$505 million in 2011-12 and similar amounts thereafter.

While the benefits of net operating loss carrybacks will be more broadly distributed than those for single sales factor apportionment or credit sharing, this provision will still disproportionately benefit very large corporate taxpayers:

- More than one-quarter (28 percent) of the benefits of loss carrybacks will go to firms that claim deductions in excess of \$100 million. At the state’s 8.84 percent corporate tax rate, a deduction of \$100 million would offset the tax on \$1.1 billion of profits.
- Corporations with gross receipts in excess of \$1 billion will claim four out of every 10 dollars of loss carryback deductions.
- Almost one-quarter (23 percent) of the benefits of net operating loss carrybacks will go to holding companies (Figure 7). Real estate firms will claim 11 percent of the benefits and banks, savings and loans, and other financial corporations will receive an estimated 16 percent of the benefits.

Figure 7: Holding Companies Would Claim Nearly One-Quarter of Net Operating Loss Carryback Deductions



Note: "Other" includes agriculture, mining, and transportation and utilities.
Source: Franchise Tax Board

Bringing It All Back Home

The business tax cuts enacted as part of the September 2008 and February 2009 budget agreements will cost the state \$8.7 billion in lost revenues between 2008-09 and 2015-16 *after* taking into account the revenue gain from the suspension of net operating loss deductions and limits on tax credit usage imposed in the September agreement. This figure includes \$9.6 billion in lost revenues from the three measures discussed in this paper; \$1.1 billion of net revenue gain from the suspension of net operating loss deductions and limits on tax credit usage included in the September 2008 agreement; and the \$775 million loss

attributable to the temporary motion picture production and hiring tax credits enacted in February.⁷ Annual revenue losses of close to \$2 billion per year and potentially as much as \$2.5 billion per year would continue in 2016-17 and beyond. The large revenue losses in 2010-11 and beyond are significant in light of multi-year budget forecasts that project that the state will face shortfalls in excess of \$25 billion per year in 2011-12 and beyond.⁸ The massive, permanent tax cuts enacted as part of recent budget agreements will exacerbate California's persistent budget troubles, requiring deeper cuts in public services or potentially larger tax increases for California's families to make up for lost revenues.

Jean Ross prepared this Budget Brief with assistance from Alissa Anderson. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.

ENDNOTES

- ¹ The February 2009 changes were contained in AB 15xxx (Krekorian). The September changes were made in AB 1452 (Committee on Budget). AB 15xxx also included several large temporary tax reductions benefitting business, including a tax credit for motion picture production activities and a tax credit for businesses that expand employment. AB 1452 suspended businesses' ability to claim net operating loss deductions in 2008 and 2009, but allows businesses to carry losses incurred in these two years forward for an additional two years, extended the carryforward period for all loss deductions, and exempted small corporations.
- ² The estimates of the distribution of the impact of credit sharing and single sales factor by size, firm, sector, and corporation discussed assume that the law had been in effect in 2006. The estimates of the distribution of the impact of net operating loss carrybacks assume that the policy had been in effect in 2007. The CBP estimated per firm and sector impacts in 2013-14 when all three of these provisions would be fully phased in.
- ³ Senate Floor Analysis of AB 15xxx as amended February 14, 2009, downloaded from http://info.sen.ca.gov/pub/09-10/bill/asm/ab_0001-0050/abx3_15_cfa_20090214_174915_sen_floor.html on May 28, 2009.
- ⁴ See, for example, Senate Revenues and Taxation Committee, *Analysis of AB 1037 (Frommer) as Amended August 7, 2006* downloaded from http://www.leginfo.ca.gov/pub/05-06/bill/asm/ab_1001-1050/ab_1037_cfa_20060807_131151_sen_comm.html on May 29, 2009 or Assembly Committee on Revenue and Taxation, *Analysis of AB 1591 (Ma) as Amended June 7, 2007* downloaded from http://www.leginfo.ca.gov/pub/07-08/bill/asm/ab_1551-1600/ab_1591_cfa_20070608_135615_asm_comm.html on May 29, 2009.
- ⁵ The budget agreement also limited the use of business tax credits to no more than 50 percent of the tax owed. Prior to this change, which applies to the 2008 and 2009 tax years, businesses could offset as much as all of their tax liability with credits. To offset the impact of this limit, the length of time businesses can carry tax credits forward was extended by two years. The limitation does not apply to businesses with taxable incomes of less than \$500,000.
- ⁶ Businesses could carryback 50 percent of losses attributable to 2011, 75 percent of losses attributable to 2012, and 100 percent of losses attributable to 2013 and thereafter. Losses could be carried back and applied to the two prior years. Losses attributable to 2008 and future years could be carried forward for 20 years. California previously allowed losses to be carried forward for 10 years. The loss carryforward suspension did not apply to taxpayers with net business incomes less than \$500,000.
- ⁷ The net gain from the suspension of NOL deductions and limits on tax credit usage in 2008 and 2009 is relatively small, since businesses can carry forward credits and deductions that might have been used in those years to reduce future years' taxes.
- ⁸ Legislative Analyst's Office, *The State Budget Situation* (May 27, 2009) downloaded from http://lao.ca.gov/handouts/FO/2009/052709_CSAC.pdf on May 28, 2008.