

California Suspends Net Operating Loss Carryovers and Limits Business Credits

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Governor Schwarzenegger has signed into law tax legislation with immediate and retroactive negative tax effects along with some future positive tax changes.

Net Operating Losses and Business Tax Credits

For taxpayers with net business income of \$500,000 or more, the new provisions

- Suspend carryovers of net operating losses (NOLs) to 2008 and 2009, and
- Suspend the use of business credits in those years in excess of 50% of a taxpayer's net tax.

Any credits not allowed may be carried over for a period that will be extended by the period of suspension. NOLs for taxable years after 2007 will have a carryover period of 20 years (rather than the 10 years previously in effect) and the NOL carryovers suspended in 2008 and 2009 will have 10 years added to their carryover periods.

A positive future change permits NOLs for 2011 and subsequent years to be carried back to the two preceding years, but will be phased in by limiting to 50% the use of a 2011 NOL and by limiting to 75% the use of a 2012 NOL. NOLs for 2013 and subsequent years may be carried back in full.

Estimated Taxes

1. *Acceleration.* Tax payments will be accelerated by increasing the size of the first two installments to 30%, rather than 25%, of estimated tax (the last two installments to be reduced to 20% of estimated tax).

2. *Limited Liability Companies.* For 2009 and subsequent years, the annual graduated fee, which is in addition to the minimum tax of \$800 per year, payable by limited liability companies will be subject to an estimated payment by the 15th day of the 6th month of the taxable year. If it turns out to be less than the fee due for the year, a 10% penalty will be imposed on the underpayment unless the estimated fee payment is at least equal to 100% or the prior year's fee.

New 20% Penalty for Large Underpayments

For corporations who underpay their tax liability by more than \$1 million, a penalty of 20% of the underpayment will be imposed in addition to all other penalties. This new penalty will be *retroactive* to taxable years after 2002. However, the retroactive aspect can be avoided if the tax is reported and paid before March 1, 2009.