State of California
Franchise Tax Board

Summary of Federal Income Tax Changes 2014

Laws Affected

Personal Income Tax Law
Corporation Tax Law
Administration of Franchise and Income Tax Laws

Summary of Federal Income Tax Changes
2014

Prepared by the Staff of the

Franchise Tax Board

STATE OF CALIFORNIA

This report is submitted in fulfillment of the requirement in Revenue and Taxation Code section 19522.

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AN ACT TO AMEND CERTAIN PROVISIONS OF THE FAA MODERNIZATION AND REFORM ACT OF 2012
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TITLE I OF DIVISION A OF PUBLIC LAW 113-295, DECEMBER 19, 2014

EXECUTIVE SUMMARY

Prepared by the Staff of the
Franchise Tax Board (FTB)
State of California

During 2014, the Internal Revenue Code (IRC) or its application by California was changed by:

PUBLIC LAW	TITLE	DATE
113-92	Philippines Charitable Giving Assistance Act	March 25, 2014
113-97	Cooperative and Small Employer Charity Pension Flexibility Act	April 7, 2014
113-159	Highway and Transportation Funding Act of 2014	August 8, 2014
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113-235 Division O	Multiemployer Pension Reform Act of 2014	December 16, 2014
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113-295 Division A, Title I	Tax Increase Prevention Act of 2014	December 19, 2014
113-295 Division A, Title II	Tax Technical Corrections Act of 2014	December 19, 2014
113-295 Division A, Title III	Joint Committee on Taxation	December 19, 2014
113-295 Division B	Achieving a Better Life Experience (ABLE) Act of 2014	December 19, 2014
113-76, 113-94, 113-121, 113-128, 113-188, Divisions D, H, and N of 113-235, and 113-287	Miscellaneous Acts Impacting the IRC Not Requiring a California Response	Various

This report explains the new 2014 federal laws along with the effective dates, the corresponding California law, if any, including an explanation of any changes made in response to the new federal law, and the impact on California revenue if California were to conform to those federal changes. This report also contains citations to the section numbers of federal Public Laws, the IRC, and the California Revenue and Taxation Code (R&TC) impacted by the federal changes.

This report contains the following exhibits:

Exhibit A	*2014 Miscellaneous Federal Acts Impacting the IRC Not Requiring a California Response* - Short explanations of federal law changes that are either not administered by the FTB or are not applicable to California.
Exhibit B	*Expiring Tax Provisions* - A complete listing of expiring provisions in California tax law.
Exhibit C	*Revenue Tables* - The impact on California revenue were California to conform to the federal changes.

Section	Section Title
2	Acceleration of Income Tax Benefits for Charitable Cash Contributions for Relief of Victims of Typhoon Haiyan in the Philippines

Background

Generally under federal law individual taxpayers who itemize deductions may deduct eligible charitable contributions from their income only for the calendar year in which the contributions are made. Corporations are also allowed to deduct eligible charitable contributions from income for the calendar year in which the contributions are made.

New Federal Law (Uncodified Act section 2 Affecting IRC section 170)

This uncodified provision allows a taxpayer, whether an individual or a corporation, to accelerate the charitable contribution deduction for cash contributions for relief efforts for Typhoon Haiyan that hit the Philippines in November 2013.

Any cash contribution made after March 25, 2014, and before April 15, 2014, for the relief of victims in areas affected by Typhoon Haiyan, may be treated as if such contribution was made on December 31, 2013, and not in 2014. Taxpayers electing to deduct such a contribution from 2013 federal taxable income will not be allowed to deduct that same contribution in 2014.

Effective Date

This provision is effective March 25, 2014.

California Law (R&TC sections 17201 and 24357 – 24357.9)

Under the Personal Income Tax Law, California generally conforms to the federal charitable contribution rules under IRC section 170 as of the "specified date" of January 1, 2009,[1] and as a result, does not conform to this accelerated contribution deduction.

Under the Corporation Tax Law, California does not conform to IRC section 170, but instead has stand-alone law that is generally similar to federal law allowing corporations a deduction for charitable contributions.[2] There is no similar accelerated contribution deduction allowable under the Corporation Tax Law.

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[1] R&TC section 17201 conforms to IRC section 170, relating to charitable, etc., contributions and gifts, as of the "specified date" of January 1, 2009, with modifications in R&TC sections 17206, 17275.2, 17275.3, and 17275.5.

[2] R&TC sections 24357 – 24359.1.

Impact on California Revenue

None (this provision expired for contributions made on or after April 15, 2014).

Sections	Section Title
201 - 203	Funding Rules Applicable to Cooperatives and Small Employer Charity Pension Plans, Definitions, and Elections

Background

Defined benefit pension plans are required to meet certain minimum funding rules. In some cases, additional contributions are required under the deficit reduction contribution rules if a single-employer defined benefit pension plan is underfunded. Additional contributions generally are not required in the case of a plan with a funded current liability percentage of at least 90 percent. A plan's funded current liability percentage is the value of plan assets as a percentage of current liability. In general, a plan's current liability means all liabilities to employees and their beneficiaries under the plan, determined using specified interest and mortality assumptions. In the case of a plan with a funded current liability percentage of less than 100 percent for the preceding plan year, estimated contributions for the current plan year must be made in quarterly installments during the current plan year.

The Pension Benefit Guarantee Corporation (PBGC) insures benefits under most single-employer defined benefit pension plans in the event the plan is terminated with insufficient assets to pay for plan benefits. The PBGC is funded in part by a flat-rate premium per plan participant, and variable-rate premiums based on the amount of unfunded vested benefits under the plan. A specified interest rate and a specified mortality table apply in determining unfunded vested benefits for this purpose.

A multiple-employer plan is a plan that is maintained by more than one employer and is not maintained pursuant to a collective bargaining agreement.[3] A multiple-employer plan is subject to the minimum funding rules for single-employer plans and to PBGC variable-rate premiums.

The Pension Protection Act of 2006 made significant reforms to the pension funding rules to strengthen the overall pension system and to reduce reliance on the PBGC, but provided a delayed effective date for the new single-employer plan funding rules in the case of a plan that was in existence on July 26, 2005, and was an eligible cooperative plan for the plan year including that date. The modified funding rules do not apply with respect to such a plan for plan years beginning before the earlier of: (1) the first plan year for which the plan ceases to be an eligible cooperative plan, or (2) January 1, 2017. In addition, in applying the present-law funding rules to an eligible cooperative plan for plan years beginning after December 31, 2007, and before the first plan year for which the new funding rules apply, the interest rate used is the interest rate applicable under the new funding rules with respect to payments expected to be made from the

[3] A plan maintained by more than one employer pursuant to a collective bargaining agreement is referred to as a multiemployer plan.

plan after the 20-year period beginning on the first day of the plan year (i.e., the third segment rate under the new funding rules). A plan is treated as an eligible cooperative plan for a plan year if it is maintained by more than one employer and at least 85 percent of the employers are (1) certain rural cooperatives;[4] or (2) certain cooperative organizations that are more than 50-percent owned by agricultural producers or by cooperatives owned by agricultural producers, or organizations that are more than 50-percent owned, or controlled by, one or more such cooperative organizations. A plan is also treated as an eligible cooperative plan for any plan year for which it is maintained by more than one employer and is maintained by a rural telephone cooperative association.

New Federal Law (IRC sections 401, 404, 412, 413, 414, 420, 433, 436, 4971, and 6059)

These provisions make parallel amendments to the IRC and the Employee Retirement Income Security Act of 1974 (ERISA) to define a "cooperative and small employer charity pension plan" (CSEC pension plan) as an employee pension benefit plan that is a defined benefit pension plan: (1) to which certain provisions of the Pension Protection Act of 2006 apply; or (2) that, as of June 25, 2010, was maintained by more than one employer all of whom were tax-exempt charitable organizations.

Minimum funding standards are established for CSEC pension plans, and allow a CSEC plan that uses a funding method that requires contributions in all years to maintain an alternative minimum funding standard account for any plan year. The Secretary of the Treasury is permitted to extend an amortization of any unfunded liability of a CSEC pension plan for up to 10 years if the Secretary determines that: (1) such extension would carry out the purposes of this Act and would provide adequate protection for plan participants and their beneficiaries, and (2) failure to permit such extension would result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation.

These provisions also set forth rules for valuation of CSEC pension plan assets, allowable contributions, and plan liquidity, and impose a lien in favor of a CSEC plan for failure to make required contributions. The Secretary of the Treasury is authorized to prescribe mortality tables to determine current liability of CSEC plans. A CSEC plan sponsor is required to establish a written funding restoration plan within 180 days after receipt of a certification from the plan actuary that the plan is in funding restoration status for a plan year.

A CSEC plan sponsor is allowed to elect not to treat such plan as a CSEC plan in plan years beginning after 2013.

The Pension Protection Act of 2006 is amended to allow a pension plan sponsor an election to cease treating a plan as an eligible charity plan for plan years beginning after 2013.

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[4] This is as defined in IRC section 401(k)(7)(B) without regard to clause (iv) thereof and includes (1) organizations engaged primarily in providing electric service on a mutual or cooperative basis, or engaged primarily in providing electric service to the public in its service area and which is exempt from tax or which is a state or local government, other than a municipality; (2) certain civic leagues and business leagues exempt from tax 80 percent of the members of which are described in (1); (3) certain cooperative telephone companies; and (4) any organization that is a national association of organizations described above.

Effective Date

These provisions are effective on April 7, 2014.

California Law (R&TC section 17501)

IRC Conformity

This provision's changes to the IRC pension rules apply under California law without regard to taxable year to the same extent as applicable for federal income tax purposes.[5]

ERISA Preemption

ERISA preempts state laws affecting pension plans; thus, this provision's parallel ERISA changes automatically apply to pension plans in California.

Impact on California Revenue

Baseline.

[5] California conforms by reference to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations), in R&TC section 17501. Additionally, California conforms by reference to IRC section 457, relating to deferred compensation plans of state and local governments and tax-exempt organizations, in R&TC section 17551.

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC sections 17501(b) and 17551(c) specifically provide that federal changes to Part I and Part III of Subchapter D of Chapter 1 of Subtitle A of the IRC, and IRC section 457, automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes (and thus adopt all changes made to those IRC sections without regard to the "specified date" contained in R&TC section 17024.5).

Section	Section Title
2001-2002	Extension of Highway Trust Fund Expenditure Authority and Funding of Highway Trust Fund

Background

The expenditure authority of the Highway Trust Fund, the Sport Fish Restoration and Boating Trust Fund, and the Leaking Underground Storage Tank Trust Fund expires on October 1, 2014.

New Federal Law (IRC sections 9503, 9504, and 9508)

These provisions extend through May 31, 2015, the authority for expenditures from the Highway Trust Fund, the Sport Fish Restoration and Boating Trust Fund, and the Leaking Underground Storage Tank Trust Fund.

Effective Date

These provisions are effective August 8, 2014.

California Law

Not applicable.

Impact on California Revenue

Not applicable.

Section	Section Title
2003	Funding Stabilization

Background

Minimum Funding Rules

A defined benefit plan maintained by a single employer is subject to minimum funding rules that generally require the sponsoring employer to make a certain level of contribution for each plan year to fund plan benefits.[6] The minimum funding rules for single-employer defined benefit plans were substantially revised by the Pension Protection Act of 2006 ("PPA").[7]

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[6] IRC section 412 and Section 302 of the Employee Retirement Income Security Act of 1974 ("ERISA"). For purposes of whether a plan is maintained by a single employer, certain related entities, such as the members of a controlled

Minimum Required Contributions

In General

The minimum required contribution for a plan year for a single-employer defined benefit plan generally depends on a comparison of the value of the plan's assets, reduced by any prefunding balance or funding standard carryover balance ("net value of plan assets"),[8] with the plan's funding target and target normal cost. The plan's funding target for a plan year is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's target normal cost for a plan year is generally the present value of benefits expected to accrue or to be earned during the plan year.

If the net value of plan assets is less than the plan's funding target, so that the plan has a funding shortfall (discussed further below), the minimum required contribution is the sum of the plan's target normal cost and the shortfall amortization charge for the plan year (determined as described below).[9] If the net value of plan assets is equal to or exceeds the plan's funding target, the minimum required contribution is the plan's target normal cost, reduced by the amount, if any, by which the net value of plan assets exceeds the plan's funding target.

Shortfall Amortization Charge

The shortfall amortization charge for a plan year is the sum of the annual shortfall amortization installments attributable to the shortfall bases for that plan year and the six previous plan years. Generally, if a plan has a funding shortfall for the plan year, a shortfall amortization base must be

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group, are treated as a single employer. Different funding rules apply to multiemployer and multiple-employer defined benefit plans, which are types of plans maintained by two or more unrelated employers. A number of exceptions to the minimum funding rules apply. For example, governmental plans (within the meaning of IRC section 414(d) and church plans (within the meaning of IRC section 414(e)) are generally not subject to the minimum funding rules. Under IRC section 4971, an excise tax applies if the minimum funding requirements are not satisfied.

[7] Public Law 109-280. The PPA minimum funding rules for single-employer plans are generally effective for plan years beginning after December 31, 2007. Subsequent changes were made by the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA"), Public Law 110-458; the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 ("PRA 2010"), Public Law 111-192; and the Moving Ahead for Progress in the 21st Century Act ("MAP-21"), Public Law 112-141.

[8] The value of plan assets is generally reduced by any prefunding balance or funding standard carryover balance in determining minimum required contributions. A prefunding balance results from plan contributions that exceed the minimum required contributions. A funding standard carryover balance results from a positive balance in the funding standard account that applied under the funding requirements in effect before the PPA. Subject to certain conditions, a prefunding balance or funding standard carryover balance may be credited against the minimum required contribution for a year, reducing the amount that must be contributed.

[9] If the plan has obtained a waiver of the minimum required contribution (a funding waiver) within the past five years, the minimum required contribution also includes the related waiver amortization charge, that is, the annual installment needed to amortize the waived amount in level installments over the five years following the year of the waiver.

established for the plan year.[10] A plan's funding shortfall is the amount by which the plan's funding target exceeds the net value of plan assets. The shortfall amortization base for a plan year is: (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases for the six previous plan years. The shortfall amortization base is amortized in level annual installments ("shortfall amortization installments") over a seven-year period beginning with the current plan year and using the segment interest rates (discussed below).[11]

The shortfall amortization base for a plan year may be positive or negative, depending on whether the present value of remaining installments with respect to amortization bases for previous years is more or less than the plan's funding shortfall. If the shortfall amortization base is positive (that is, the funding shortfall exceeds the present value of the remaining installments), the related shortfall amortization installments are positive. If the shortfall amortization base is negative, the related shortfall amortization installments are negative. The positive and negative shortfall amortization installments for a particular plan year are netted when adding them up in determining the shortfall amortization charge for the plan year, but the resulting shortfall amortization charge cannot be less than zero (i.e., negative amortization installments may not offset normal cost).

If the net value of plan assets for a plan year is at least equal to the plan's funding target for the year, so the plan has no funding shortfall, any shortfall amortization bases and related shortfall amortization installments are eliminated.[12] As indicated above, if the net value of plan assets exceeds the plan's funding target, the excess is applied against target normal cost in determining the minimum required contribution.

Interest Rate Used to Determine Target Normal Cost and Funding Target

The minimum funding rules for single-employer plans specify the interest rates and certain other actuarial assumptions that must be used in determining the present value of benefits for purposes of a plan's target normal cost and funding target.

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[10] If the value of plan assets, reduced only by any prefunding balance if the employer elects to apply the prefunding balance against the required contribution for the plan year, is at least equal to the plan's funding target, no shortfall amortization base is established for the year.

[11] Under the PRA 2010, employers were permitted to elect to use one of two alternative extended amortization schedules for up to two "eligible" plan years during the period 2008-2011. The use of an extended amortization schedule has the effect of reducing the amount of the shortfall amortization installments attributable to the shortfall amortization base for the eligible plan year. However, the shortfall amortization installments attributable to an eligible plan year may be increased by an additional amount, an "installment acceleration amount," in the case of employee compensation exceeding $1 million, extraordinary dividends, or stock redemptions within a certain period of the eligible plan year.

[12] Any amortization base relating to a funding waiver for a previous year is also eliminated.

Present value is generally determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period.[13] The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year;[14] the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period. Under the funding rules as enacted in the PPA ("PPA" rules), each segment rate is a single interest rate determined monthly by the Secretary of the Treasury ("Secretary"), on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. The corporate bond yield curve used for this purpose reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The IRS publishes the segment rates each month.

Under the Moving Ahead for Progress in the 21st Century Act ("MAP-21"), for plan years beginning after December 31, 2011, a segment rate determined under the PPA rules is adjusted if it falls outside a specified percentage range of the average segment rates for a preceding period. In particular, if a segment rate determined under the PPA rules is less than the applicable minimum percentage in the specified range, the segment rate is adjusted upward to match the minimum percentage. If a segment rate determined under the PPA rules is more than the applicable maximum percentage in the specified range, the segment rate is adjusted downward to match the maximum percentage. For this purpose, an average segment rate is the average of the segment rates determined under the PPA rules for the 25-year period ending September 30 of the calendar year preceding the calendar year in which the plan year begins. The Secretary is to determine average segment rates on an annual basis and may prescribe equivalent rates for any years in the 25-year period for which segment rates determined under the PPA rules are not available. The Secretary is directed to publish the average segment rates each month.

The specified percentage range (that is, the range from the applicable minimum percentage to the applicable maximum percentage) for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012,
- 85 percent to 115 percent for 2013,
- 80 percent to 120 percent for 2014,
- 75 percent to 125 percent for 2015, and
- 70 percent to 130 percent for 2016 or later.

[13] Solely for purposes of determining minimum required contributions, in lieu of the segment rates, an employer may elect to use interest rates on a yield curve based on the yields on investment grade corporate bonds for the month preceding the month in which the plan year begins (*i.e.*, without regard to the 24-month averaging described above) ("monthly yield curve"). If an election to use a monthly yield curve is made, it cannot be revoked without IRS approval.

[14] Subject to an exception for small plans with no more than 100 participants, the annual valuation date for a plan must be the first day of the plan year. Thus, except for small plans with valuation dates other than the first day of the plan year, the period for which the first segment rate applies begins on the valuation date.

Funding-Related Benefit Restrictions

Special rules may apply to a plan if its funding target attainment percentage is below a certain level.[15] A plan's funding target attainment percentage for a plan year is the ratio—expressed as a percentage—that the net value of plan assets bears to the plan's funding target for the year. Because a plan's funding target is a component of the plan's funding target attainment percentage, the interest rate used in determining the plan's funding target generally applies also in determining the plan's funding target attainment percentage.[16]

Restrictions on benefit increases, certain types of benefit payments ("prohibited payments") and benefit accruals (collectively referred to as "benefit restrictions") may apply to a plan if the plan's adjusted funding target attainment percentage is below a certain level.[17] The plan's adjusted funding target attainment percentage is determined in the same way as funding target attainment percentage, except that the net value of plan assets and the plan's funding target are both increased by the aggregate amount of purchases of annuities for employees, other than highly-compensated employees, made by the plan during the two preceding plan years. Although anti-cutback rules generally prohibit reductions in benefits that have already been earned under a plan,[18] reductions required to comply with the benefit restrictions are permitted.

Under these rules, a prohibited payment generally means (1) any payment in excess of the monthly benefit amount paid under a single life annuity (plus any social security supplement), or (2) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits. Prohibited payments generally may not be made if the plan's adjusted funding target attainment percentage is less than 60 percent. If a plan's adjusted funding target attainment percentage is at least 60 percent, but less than 80 percent, prohibited payments may be made, but subject to limits. In addition, prohibited payments may not be made during any period in which the plan sponsor is a debtor in a bankruptcy proceeding under federal or state law unless the plan's adjusted funding target attainment percentage is at least 100 percent.

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[15] For example, funding target attainment percentage is used to determine whether a plan is in "at-risk" status, so that special actuarial assumptions ("at-risk assumptions") must be used in determining the plan's funding target and target normal cost. A plan is in at-risk status for a plan year if, for the preceding year: (1) the plan's funding target attainment percentage, determined without regard to the at-risk assumptions, was less than 80 percent, and (2) the plan's funding target attainment percentage, determined using the at-risk assumptions (without regard to whether the plan was in at-risk status for the preceding year), was less than 70 percent. A similar test applies in order for an employer to be permitted to apply a prefunding balance against its required contribution, that is, for the preceding year, the ratio of the value of plan assets (reduced by any prefunding balance) must be at least 80 percent of the plan's funding target (determined without regard to the at-risk rules).

[16] The adjustments to the segment rates under MAP-21 do not apply for certain other purposes for which the segment rates are used, for example, in calculating the limits on deductible contributions to single-employer defined benefit plans under IRC section 404.

[17] IRC sections 401(a)(29) and 436 and ERISA section 206(g).

[18] IRC section 411(d)(6) and ERISA section 204(g).

Annual Funding Notice

The plan administrator of a single-employer defined benefit plan must provide an annual funding notice to each participant and beneficiary, each labor organization representing such participants or beneficiaries, and the Pension Benefit Guaranty Corporation ("PBGC").[19] In addition to the information required to be provided in all funding notices, in the case of a single-employer defined benefit plan, the notice must include (1) the plan's funding target attainment percentage for the plan year to which the notice relates and the two preceding plan years, (2) the value of the plan's assets and benefit liabilities (that is, the present value of benefits owed under the plan) for the plan year and the two preceding years, determined in the same manner as under the funding rules, and (3) the value of the plan's assets and benefit liabilities as of the last day of the plan year to which the notice relates, determined using the fair market value of plan assets (rather value determined under the funding rules) and, in computing benefit liabilities, the interest rates used in computing variable-rate PBGC premiums.[20]

Under MAP-21, additional information must be included in the annual funding notice in the case of an applicable plan year. For this purpose, an applicable plan year is any plan year beginning after December 31, 2011, and before January 1, 2015, for which (1) the plan's funding target, determined using segment rates as adjusted to reflect average segment rates ("adjusted" segment rates), is less than 95 percent of the funding target determined without regard to adjusted segment rates, (2) the plan has a funding shortfall, determined without regard to adjusted segment rates, greater than $500,000, and (3) the plan had 50 or more participants on any day during the preceding plan year. Specifically, the notice must include (1) a statement that MAP-21 modified the method for determining the interest rates used to determine the actuarial value of benefits earned under the plan, providing for a 25-year average of interest rates to be taken into account in addition to a two-year average, (2) a statement that, as a result of MAP-21, the plan sponsor may contribute less money to the plan when interest rates are at historical lows, and (3) a table showing, for the applicable plan year and each of the two preceding plan years,[21] the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution, each determined both using adjusted segment rates and without regard to adjusted segment rates.

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[19] ERISA section 101(f), originally enacted by section 103 of the Pension Funding Equity Act of 2004 (Public Law 108-218). Annual funding notice requirements, with some differences, apply also to multiemployer and multiple-employer plans.

[20] In applying the funding rules, the value of plan assets may be determined on the basis of average fair market values over a period of up to 24 months. PBGC variable-rate premiums are based on a plan's unfunded vested benefit liabilities, computed using the first, second and third segment rates as determined under the PPA rules (without adjustments under MAP-21), but based on a monthly corporate bond yield curve, rather than a yield curve reflecting average yields for a 24-month period.

[21] In the case of a preceding plan year beginning before January 1, 2012, only the plan's funding target attainment percentage, funding shortfall, and the employer's minimum required contribution determined without regard to adjusted segment rates are required to be provided.

New Federal Law (IRC sections 430 and 436)

Applicable Minimum and Maximum Percentages and Annual Funding Notice

The provision makes parallel changes to the IRC and ERISA to revise the specified percentage ranges (that is, the range from the applicable minimum percentage to the applicable maximum percentage of average segment rates) for determining whether a segment rate must be adjusted upward or downward. Under this provision, the specified percentage range for a plan year is determined by reference to the calendar year in which the plan year begins as follows:

- 90 percent to 110 percent for 2012 through 2017,
- 85 percent to 115 percent for 2018,
- 80 percent to 120 percent for 2019,
- 75 percent to 125 percent for 2020, and
- 70 percent to 130 percent for 2021 or later.

In addition, for purposes of the additional information that must be provided in a funding notice for an applicable plan year, an applicable plan year includes any plan year that begins after December 31, 2011, and before January 1, 2020, and that otherwise meets the definition of applicable plan year.

Periods for Determining Segment Rates

The provision revises the period of benefit payments to which the segment rates (or adjusted segment rates) apply. Under the provision, the first rate applies to benefits reasonably determined to be payable during the five-year period beginning on the plan's valuation date (rather than the first day of the plan year as under present law); the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable at the end of the 15-year period.[22]

Effective Date

The provisions relating to the applicable minimum and maximum percentages, the annual funding notice, and periods for determining segment rates are generally effective for plan years beginning after December 31, 2012. Under a special rule, an employer may elect, for any plan year beginning before January 1, 2014, not to have these provisions apply either (1) for all purposes for which the provisions would otherwise apply, or (2) solely for purposes of determining the plan's adjusted funding target attainment percentage in applying the benefit restrictions for that year. A plan will not be treated as failing to meet the requirements of the anti-cutback rules solely by reason of an election under the special rule.

[22] The provision does not change the requirement that the valuation date for plans other than certain small plans must be the first day of the plan year. Thus, the provision does not change these periods for plans for which the valuation date must be the first day of the plan year.

California Law (R&TC sections 17501 and 17551)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[23] including this provision's extension of the automatic extension of amortization periods.

ERISA Preemption

ERISA preempts state laws affecting pension plans; thus, the parallel extension under ERISA automatically applies to pension plans in California.

Impact on California Revenue

Baseline.

[23] R&TC section 17501 conforms by reference to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations). Additionally, California conforms by reference to IRC 457, relating to deferred compensation plans of state and local governments and tax-exempt organizations, in R&TC section 17551.

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC sections 17501(b) and 17551(c) specifically provide that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC, and IRC section 457, automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Section	Section Title
2-4	Indian General Welfare Benefits

Background

Federal Taxation of Indian Tribes

Indian tribal governments have a unique legal status. They have inherent sovereignty and a government-to-government relationship with the United States.

Prior to this Act, there were generally no specific IRC provisions that governed the U.S. income tax liability of Indian tribes.[24] The Internal Revenue Service (IRS) has long taken the position that federally-recognized Indian tribes and wholly owned tribal corporations chartered under section 17 of the Indian Reorganization Act of 1934[25] and section 3 of the Oklahoma Indian Welfare Act[26] are not taxable entities for U.S. income tax purposes and are exempt from U.S. income taxes, regardless of whether the activities that produced the income are commercial or noncommercial in nature or are conducted on or off the Indian tribe's reservation.[27] In contrast, a corporation organized under state law and owned by an Indian tribe or tribal members may be subject to U.S. income tax on income earned from activities conducted on or off the Indian tribe's reservation.[28]

The General Welfare Exclusion

Payments made to or on behalf of individuals or other persons under governmental programs are included within the broad definition of gross income under IRC section 61 unless an exclusion from income applies.[29] The IRS has consistently concluded, however, that certain payments made to or on behalf of individuals by governmental units under governmentally provided social benefit programs for the promotion of the general welfare are not included in a recipient's gross income (i.e., the general welfare exclusion).

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[24] However, IRC section 7871 provides that Indian tribes (referred to as "Indian tribal governments") are treated as states for certain federal tax purposes.

[25] 25 U.S.C. section 477.

[26] 25 U.S.C. sections 501-509.

[27] See, *e.g.*, Revenue Ruling 94-65, 1994-2 C.B. 14 (extending Revenue Ruling 94-16 to Oklahoma tribal corporations organized under the Oklahoma Indian Welfare Act); Revenue Ruling 94-16, 1994-1 C.B. 19 (neither an unincorporated Indian tribe nor a corporation organized under section 17 of the Indian Reorganization Act of 1934 is subject to federal income tax on its income); Revenue Ruling 81-295, 1981-2 C.B. 15 (Federally chartered Indian tribal corporation has the same tax status as the tribe and is not taxable); and Revenue Ruling 67-284, 1967-2 C.B. 55 (Indian tribes are not taxable entities).

[28] See Revenue Ruling 94-16, 1994-1 C.B. 1 and Revenue Ruling 94-65, 1994-2 C.B. 14.

[29] See Notice 2003-18, 2003-1 C.B. 699; Rev. Rul. 79-356, 1979-2 C.B. 28.

To qualify under the general welfare exclusion, payments must: (1) be made pursuant to a governmental program, (2) be for the promotion of the general welfare (that is, based on individual need), and (3) not represent compensation for services.

Indian Tribal Benefits

The general welfare exclusion applies to payments by Indian tribal governments no less favorably than it applies to payments made by other governmental units. However, the general-welfare requirements that the payments be for the promotion of the general welfare (that is, the individual-need requirement), and not represent compensation for services, have been perceived by the IRS to preclude the general welfare exclusion from applying to certain payments from certain Indian tribal programs, resulting in disagreements between tribal members and the IRS over the taxation of certain tribal payments. As a result, the IRS consulted with tribal leaders and members of Indian tribes, and issued Notice 2011-94, 2011-49 I.R.B. 834 to invite comments concerning the application of the general welfare exclusion to Indian tribal government programs that provide benefits to tribal members. In response to comments received, the IRS issued Notice 2012-75, 2012-51 I.R.B., which proposed a revenue procedure that would provide certain safe harbors under which certain benefits from Indian tribal government programs would qualify under the general welfare exclusion.

In response to Notice 2012-75, the IRS received additional comments, made changes and clarifications to the proposed revenue procedure of that notice, and on June 3, 2014, issued Revenue Procedure 2014-35, which describes principles of the general welfare exclusion and provides safe harbors under which the IRS would conclusively presume that (1) the individual-need requirement of the general welfare exclusion would be met for specified benefits provided under described Indian tribal government programs, and (2) certain benefits an Indian tribal government provides under other described benefit programs are not compensation for services.

Revenue Procedure 2014-35 is effective for benefits provided on or after December 6, 2012. Taxpayers may apply Revenue Procedure 2014-35 for taxable years for which the federal statute of limitations under IRC section 6511 has not expired.

<u>New Federal Law (IRC section 139E)</u>

This provision generally codifies the provisions of Revenue Procedure 2014-35 by adding IRC section 139E to exclude the value of an Indian general welfare benefit from gross income, and makes additional changes relating to tribal taxation.

An Indian tribal welfare benefit includes any payment or services provided to or on behalf of a member of an Indian tribe (or any spouse or dependent of such member) pursuant to an Indian tribal government program. The program must be administered under specific guidelines and cannot discriminate in favor of members governing the tribe, and benefits under the program must be available to any tribal member who meets such guidelines and for the promotion of general welfare, and may not be lavish or extravagant or compensation for services.

The Secretary of the Treasury is required to, in consultation with the Tribal Advisory Committee (as established under this provision), establish guidelines for what constitutes lavish or extravagant benefits with respect to Indian tribal government programs. Any items of cultural significance, reimbursement of costs, or cash honorarium for participation in cultural or ceremonial activities for the transmission of tribal culture may not be treated as compensation for services.

Ambiguities in the Indian general welfare benefit exclusion are to be resolved in favor of Indian tribal governments and that deference must be given to Indian tribal governments for the programs administered and authorized by the tribe to benefit the general welfare of the tribal community.

This provision directs the Secretary of the Treasury to: (1) establish a Tribal Advisory Committee to advise the Secretary on the taxation of Indians, (2) establish and require education and training for IRS field agents on federal Indian law and implementation of this provision, and (3) suspend audit and examination of Indian tribal governments and members of Indian tribes and waive any interest or penalties related to the exclusion from gross income of Indian general welfare benefits until the education and training prescribed by this provision is completed. This provision suspends the statute of limitations with respect to Indian tribal governments and members of Indian tribes during the period which audits and examinations are suspended.

This provision also allows the Secretary of the Treasury to waive any interest and penalties imposed under the IRC on any Indian tribal government or member of an Indian tribe (or any spouse or dependent of such member) to the extent such interest and penalties relate to excluding a payment or benefit from gross income under the general welfare exclusion.

Effective Date

This provision applies to taxable years for which the period of limitation on refund or credit under IRC section 6511 has not expired as of September 26, 2014. If the period of limitation on a credit or refund resulting from this provision expires before the end of the one-year period beginning on September 26, 2014, refund or credit of such overpayment (to the extent applicable to this Act) may, nevertheless, be made or allowed if the claim is filed before the close of that one-year period.

California Law (R&TC sections 17071 and 17131)

State Taxation of Indian Tribal Members

Income received by an Indian tribal member who lives in that tribe's Indian country (i.e. a reservation, a dependent Indian community, or an Indian trust allotment) is exempt from California income tax if such income is sourced in the tribal member's Indian country.[30]

[30] For example, Indian tribes that conduct gaming activities on Indian country in California may use gaming profits for all tribe members' general welfare. Tribes are allowed to distribute gaming income to each tribal member on a per-capita basis after meeting or accounting for tribal obligations, and that income is exempt only if the tribal member resides in that tribe's Indian country.

Additionally, income earned by a tribal member for services performed on the reservation by tribal members who live on their reservation is exempt from state taxation, whether it is paid by the tribe or by a third party. The exemption of income with respect to Indian tribal members does not apply to tribal members who live outside the tribe's Indian country or to income earned for services performed outside the tribe's Indian country.

Exclusion from Gross Income for Indian Tribal Welfare Benefits

California generally conforms to the federal definition of gross income under IRC section 61 (and to the general welfare exclusion),[31] and to the computation of taxable income under Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC,[32] as of the "specified date" of January 1, 2009. Because this provision (to codify the exclusion from gross income of Indian tribal welfare benefits by adding IRC section 139E) was enacted after the "specified date," California does not conform to it. However, California conforms to the broad definition of gross income under IRC section 61 (including the general welfare exclusion); thus, the provisions of Revenue Procedure 2014-35 apply for purposes of determining whether payments from Indian tribal programs qualify under the general welfare exclusion for California purposes.

<u>Impact on California Revenue</u>

Baseline.

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[31] R&TC section 17071.

[32] R&TC section 17131.

<u>Section</u>	<u>Section Title</u>
101	Repeal of Sunset of PPA Funding Rules

<u>Background</u>

Defined benefit pension plans generally are subject to minimum funding rules under the IRC that require the sponsoring employer to periodically make contributions to fund plan benefits. Similar rules apply to defined benefit pension plans under the Labor Code provisions of ERISA.

The minimum funding rules for single-employer and multiemployer plans are different.[33] A single-employer plan is a plan that is not a multiemployer plan. A multiemployer plan is generally a plan to which more than one employer is required to contribute and which is maintained pursuant to a collective bargaining agreement.[34]

Funding Standard Account

A multiemployer defined benefit pension plan is required to maintain a special account called a "funding standard account" to which charges and credits (such as credits for plan contributions) are made for each plan year. If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, the plan has an "accumulated funding deficiency" equal to the amount of such excess charges. For example, if the balance of charges to the funding standard account of a plan for a year would be $200,000 without any contributions, then a minimum contribution equal to that amount is required to meet the minimum funding standard for the year to prevent an accumulated funding deficiency. If credits to the funding standard account exceed charges, then the result is a credit balance. The amount of the credit balance, increased with interest, can be used to reduce future required contributions.

Amortization Periods

A plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an acceptable actuarial cost method breaks up the cost of benefits under the plan into annual charges consisting of two elements for each plan year. These elements are referred to as the: (1) normal cost; and (2) amortization of supplemental cost. The normal cost for a plan for a plan year generally represents the cost of future benefits allocated to the plan year under the funding method used by the plan for current employees. The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets, such as a net

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[33] The Pension Protection Act of 2006 modified the minimum funding rules for multiemployer defined benefit pension plans. These modifications are generally effective for plan years beginning after 2007.

[34] IRC section 414(f).

experience loss. Supplemental costs are amortized (i.e., recognized for funding purposes) over a specified number of years, depending on the source. The amortization period applicable to a multiemployer plan for most credits and charges is 15 years.[35] Past service liability under the plan is amortized over 15 years; past service liability due to plan amendments is amortized over 15 years; and experience gains and losses resulting from a change in actuarial assumptions are amortized over 15 years. Experience gains and losses and waived funding deficiencies are also amortized over 15 years.

The Secretary, upon receipt of an application, is required to grant an extension of the amortization period for up to five years with respect to any unfunded past service liability, investment loss, or experience loss.[36] There must be included with the application a certification by the plan's actuary that: (1) absent the extension, the plan would have an accumulated funding deficiency in the current plan year and any of the nine succeeding plan years; (2) the plan sponsor has adopted a plan to improve the plan's funding status; (3) taking into account the extension, the plan is projected to have sufficient assets to timely pay its expected benefit liabilities and other anticipated expenditures; and (4) required notice has been provided. The automatic extension provision does not apply with respect to any application submitted after December 31, 2014.

The Secretary may also grant an additional extension of such amortization periods for an additional five years, using the same standards for determining whether such an extension may be granted as under the pre-PPA minimum funding rules.[37]

<u>New Federal Law (IRC section 431)</u>

This provision makes parallel changes to the IRC and the Employment Retirement Security Act of 1974 (ERISA) to repeal the December 31, 2014, termination date of the automatic extension provision that requires the Secretary, upon receipt of an application, to grant an extension of the amortization period for up to five years.

<u>Effective Date</u>

This provision is effective on December 16, 2014.

<u>California Law (R&TC section 17501)</u>

IRC Conformity

In general, California automatically conforms to the federal pension rules,[38] including this provision's repeal of the automatic extension provision.

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[35] IRC section 431(b)(2).

[36] IRC section 431(d)(1).

[37] IRC section 431(d)(2).

[38] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
102	Election to Be in Critical Status

Background

In General

The Pension Protection Act of 2006 (PPA) provided additional funding rules for multiemployer defined benefit plans in effect on July 16, 2006, that were in endangered or critical status. The provision requires the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status.

Critical Status

In the case of a plan in critical status, additional required contributions and benefit reductions apply and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

1. The funded percentage of the plan is less than 65 percent and the sum of the market value of plan assets, plus the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

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Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

2. The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,

3. The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

4. The sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect), is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

<u>New Federal Law (IRC section 432)</u>

This provision makes parallel changes to the IRC and ERISA to provide that any plan that is not in critical status for the plan year but is projected by the plan's actuary to be in critical status in any of the succeeding five plan years may elect to critical status in the current plan year if such election is made within 30 days of the plan actuary's certification that the plan is projected to be in critical status in a succeeding plan year.

<u>Effective Date</u>

The provision is effective with respect to plan years beginning after December 31, 2014.

<u>California Law (R&TC section 17501)</u>

IRC Conformity

In general, California automatically conforms to the federal pension rules,[39] including this provision's election to be in critical status.

[39] *Ibid.*

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
103	Clarification of Rule for Emergence from Critical Status

Background

In General

The Pension Protection Act of 2006 (PPA) provided additional funding rules for multiemployer defined benefit plans in effect on July 16, 2006, that were in endangered or critical status. The provision requires the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status.

Critical Status

In the case of a plan in critical status, additional required contributions and benefit reductions apply and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

1. The funded percentage of the plan is less than 65 percent and the sum of the market value of plan assets, plus the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

2. The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,

3. The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

4. The sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect), is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

Rehabilitation Plan

If a plan is in critical status for a plan year, the plan sponsor must adopt a rehabilitation plan within 240 days following the required date for the actuarial certification of critical status.[40] A rehabilitation plan is a plan which consists of actions, including options or a range of options to be proposed to the bargaining parties, formulated, based on reasonable anticipated experience and reasonable actuarial assumptions, to enable the plan to cease to be in critical status by the end of the rehabilitation period and may include reductions in plan expenditures (including plan mergers and consolidations), reductions in future benefits accruals or increases in contributions, if agreed to by the bargaining parties, or any combination of such actions.

A rehabilitation plan must provide annual standards for meeting the requirements of the rehabilitation. The plan must also include the schedules required to be provided to the bargaining parties.

If the plan sponsor determines that based on reasonable actuarial assumptions and upon exhaustion of all reasonable measures the plan cannot reasonably be expected to emerge from critical status by the end of the rehabilitation period, then the plan must include reasonable measures to emerge from critical status at a later time or to forestall possible insolvency. In such case, the plan must set forth alternatives considered, explain why the plan is not reasonably expected to emerge from critical status by the end of the rehabilitation period, and specify when, if ever, the plan is expected to emerge from critical status in accordance with the rehabilitation plan.

As previously discussed, the plan sponsor must annually update the rehabilitation plan and must file the update with the plan's annual report.

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[40] The requirement applies with respect to the initial critical year.

Rehabilitation Period

The rehabilitation period is the 10-year period beginning on the first day of the first plan year following the earlier of: (1) the second anniversary of the date of adoption of the rehabilitation plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of critical status for the initial critical year and covering at least 75 percent of the active participants in the plan.

The rehabilitation period ends if the plan emerges from critical status. A plan in critical status remains in critical status until a plan year for which the plan actuary certifies that the plan is not projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method and taking into account amortization period extensions.

<u>New Federal Law (IRC section 432)</u>

This provision makes parallel changes to the IRC and ERISA to clarify the rules relating to a plan emerging from critical status.

Emerging from Critical Status

In General

The provision provides that a plan in critical status shall remain in such status until a plan year that the plan actuary certifies that (1) the plan is not in critical status as of the beginning of the plan year, (2) the plan is not projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method but taking into account any extension of amortization periods, and (3) the plan is not projected to become insolvent for any of the 30 succeeding plan years.

Special Emergence Rule

Notwithstanding the general emergence rule described above, a plan in critical status that has an automatic extension of amortization periods under IRC section 431(d)(1) will no longer be in critical status if the plan actuary certifies for a plan year that (1) the plan is not projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method but taking into account any extension of amortization periods in effect prior to the Pension Protection Act of 2006, and (2) the plan is not projected to become insolvent for any of the 30 succeeding plan years, regardless of whether the plan is in critical status as of the beginning of the plan year.

Reentry into Critical Status

A plan that emerges from critical status may not reenter critical status for any subsequent plan year unless (1) the plan is projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method, but taking into account any extension of amortization periods under IRC section 431(d), or (2) the plan is projected to become insolvent for any of the 30 succeeding plan years.

Effective Date

The provision applies with respect to plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[41] including this provision's clarification of emerging from critical status.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

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[41] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Section	Section Title
104	Endangered Status Not Applicable if No Additional Action Is Required

Background

The Pension Protection Act of 2006 (PPA) provided additional funding rules for multiemployer defined benefit plans in effect on July 16, 2006, that were in endangered or critical status. The provision requires the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status.

Endangered Status

In General

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year: (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over the accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.

New Federal Law (IRC section 432)

This provision makes parallel changes to the IRC and ERISA to add a special rule that provides a plan will not be in endangered status if as part of the actuarial certification of endangerment the plan actuary certifies that the plan is projected to no longer be in endangered status as of the tenth plan year ending after the plan year to which the certification relates without any further action to the plan.

Effective Date

This provision applies with respect to plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[42] including this provision's special rule relating to endangered status.

[42] *Ibid.*

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
105	Correct Endangered Status Funding Improvement Plan Target Funded Percentage

Background

Funding Improvement Plan and Funding Improvement Period

In the case of a multiemployer plan in endangered status, a funding improvement plan must be adopted within 240 days following the deadline for certifying a plan's status.[43] A funding improvement plan is a plan which consists of the actions, including options or a range of options, to be proposed to the bargaining parties, formulated to provide, based on reasonably anticipated experience and reasonable actuarial assumptions, for the attainment by the plan of certain requirements.

The funding improvement plan must provide that during the funding improvement period, the plan will have a certain required increase in the funded percentage and no accumulated funding deficiency for any plan year during the funding improvement period, taking into account amortization extensions (the "applicable benchmarks"). In the case of a plan that is not in seriously endangered status, under the applicable benchmarks, the plan's funded percentage must increase such that the funded percentage as of the close of the funding improvement period equals or exceeds a percentage equal to the sum of (1) the funded percentage at the beginning of the period, plus (2) 33 percent of the difference between 100 percent and the funded percentage at the beginning of the period. Thus, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-third during the funding improvement period. The funding improvement period is the 10-year period beginning on the first day of the first plan year beginning after the earlier of (1) the second anniversary of the date of adoption of the funding improvement plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of endangered status for the initial determination year and covering, as of such date, at least 75 percent of the plan's active participants. The period ends if the plan is no longer in endangered status or if the plan enters critical status.

[43] This requirement applies for the initial determination year (i.e., the first plan year that the plan is in endangered status).

In the case of a plan in seriously endangered status that is funded 70 percent or less, under the applicable benchmarks, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-fifth during the funding improvement period. In the case of such plans, a 15-year funding improvement period is used. In the case of a seriously endangered plan that is more than 70-percent funded as of the beginning of the initial determination year, the same benchmarks apply for plan years beginning on or before the date on which the last collective bargaining agreements in effect on the date for actuarial certification for the initial determination year and covering at least 75 percent of active employees in the multiemployer plan have expired if the plan actuary certifies within 30 days after certification of endangered status that the plan is not projected to attain the funding percentage increase otherwise required by the provision. Thus, for such plans, the difference between 100 percent and the plan's funded percentage at the beginning of the period must be reduced by at least one-fifth during the 15-year funding improvement period. For subsequent years for such plans, if the plan actuary certifies that the plan is not able to attain the increase generally required under the provision, the same benchmarks continue to apply.

The plan sponsor must annually update the funding improvement plan and must file the update with the plan's annual report.

If, for the first plan year following the close of the funding improvement period, the plan's actuary certifies that the plan is in endangered status, such year is treated as an initial determination year. Thus, a new funding improvement plan must be adopted within 240 days of the required certification date. In such case, the plan may not be amended in a manner inconsistent with the funding improvement plan in effect for the preceding plan year until a new funding improvement plan is adopted.

<u>New Federal Law (IRC section 432)</u>

This provision makes parallel changes to the IRC and ERISA to provide that the target funded percentage for funding improvement plans will be based on the plans funded percentage at the time of a plan actuary's certification of endangered status rather than the projected funded percentage at the beginning of the funding improvement period.

<u>Effective Date</u>

This provision is effective with respect to plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[44] including this provision's correction to the endangered status funding improvement plan target funded percentage.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
106	Conforming Endangered Status and Critical Status Rules during Funding Improvement and Rehabilitation Plan Adoption Periods

Background

The Pension Protection Act of 2006 modified the funding rules for certain multiemployer defined benefit plans that are in endangered or critical status. The provision requires the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status.

In the case of a plan in critical status, additional required contributions and benefit reductions apply and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

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[44] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Endangered Status

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year: (1) the plan's funded percentage for the plan year is less than 80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over the accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.

Critical Status

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

1. The funded percentage of the plan is less than 65 percent and the sum of the market value of plan assets, plus the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

2. The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,

3. The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

4. The sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect), is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

Requirements Pending Approval of Plan and During Funding Improvement Period

Certain restrictions apply during the period beginning on the date of certification for the initial determination year and ending on the day before the first day of the funding improvement period (the "funding plan adoption period").

During the funding plan adoption period, the plan sponsor may not accept a collective bargaining agreement or participation agreement that provides for: (1) a reduction in the level of contributions for any participants; (2) a suspension of contributions with respect to any period of service; or (3) any new or indirect exclusion of younger or newly hired employees from plan participation.

In addition, during the funding plan adoption period, except in the case of amendments required as a condition of qualification under the IRC or to apply with other applicable law, no amendment may be adopted which increases liabilities of the plan by reason of any increase in benefits, any change in accrual of benefits, or any change in the rate at which benefits become nonforfeitable under the plan.

In the case of a plan in seriously endangered status, during the funding plan adoption period the plan sponsor must take all reasonable actions (consistent with the terms of the plan and present law) which are expected, based on reasonable assumptions, to achieve an increase in the plan's funded percentage and a postponement of an accumulated funding deficiency for at least one additional plan year. These actions include applications for extensions of amortization periods, use of the shortfall funding method in making funding standard account computations, amendments to the plan's benefit structure, reductions in future benefit accruals, and other reasonable actions.

Upon adoption of a funding improvement plan, the plan may not be amended to be inconsistent with the funding improvement plan. During the funding improvement period, a plan sponsor may not accept a collective bargaining agreement or participation agreement with respect to the multiemployer plan that provides for: (1) a reduction in the level of contributions for any participants; (2) a suspension of contributions with respect to any period of service, or (3) any new direct or indirect exclusion of younger or newly hired employees from plan participation.

After the adoption of a funding improvement plan, a plan may not be amended to increase benefits, including future benefit accruals, unless the plan actuary certifies that the benefit increase is consistent with the funding improvement plan and is paid for out of contributions not required by the funding improvement plan to meet the applicable benchmark in accordance with the schedule contemplated in the funding improvement plan.

<u>New Federal Law (IRC section 432)</u>

This provision makes parallel changes to the IRC and ERISA to modify the rules that apply to endangered status plans during the adoption and funding improvement periods to be similar to the rules that apply to critical status plans.

Effective Date

The provision is effective with respect to plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[45] including this provision's modifications to make the rules the same for endangered status and critical status plans during funding improvement and rehabilitation plan adoption periods.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
107	Corrective Plan Schedules When Parties Fail to Adopt in Bargaining

Background

The Pension Protection Act of 2006 modified the funding rules for certain multiemployer defined benefit plans that are in endangered or critical status. The provision requires the adoption of and compliance with (1) a funding improvement plan in the case of a multiemployer plan in endangered status, and (2) a rehabilitation plan in the case of a multiemployer plan in critical status.

In the case of a plan in critical status, additional required contributions and benefit reductions apply and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

Endangered Status

A multiemployer plan is in endangered status if the plan is not in critical status and, as of the beginning of the plan year: (1) the plan's funded percentage for the plan year is less than

[45] *Ibid.*

80 percent, or (2) the plan has an accumulated funding deficiency for the plan year or is projected to have an accumulated funding deficiency in any of the six succeeding plan years (taking into account amortization extensions). A plan's funded percentage is the percentage of plan assets over the accrued liability of the plan. A plan that meets the requirements of both (1) and (2) is treated as in seriously endangered status.

Critical Status

A multiemployer plan is in critical status for a plan year if as of the beginning of the plan year:

1. The funded percentage of the plan is less than 65 percent and the sum of the market value of plan assets, plus the present value of reasonably anticipated employer and employee contributions for the current plan year and each of the six succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect) is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the six succeeding plan years (plus administrative expenses),

2. The plan has an accumulated funding deficiency for the current plan year, not taking into account any amortization extension, or the plan is projected to have an accumulated funding deficiency for any of the three succeeding plan years (four succeeding plan years if the funded percentage of the plan is 65 percent or less), not taking into account any amortization extension,

3. The plan's normal cost for the current plan year, plus interest for the current plan year on the amount of unfunded benefit liabilities under the plan as of the last day of the preceding year, exceeds the present value of the reasonably anticipated employer contributions for the current plan year, the present value of nonforfeitable benefits of inactive participants is greater than the present value of nonforfeitable benefits of active participants, and the plan has an accumulated funding deficiency for the current plan year, or is projected to have an accumulated funding deficiency for any of the four succeeding plan years (not taking into account amortization period extensions), or

4. The sum of (A) the market value of plan assets, plus (B) the present value of the reasonably anticipated employer contributions for the current plan year and each of the four succeeding plan years (assuming that the terms of the collective bargaining agreements continue in effect), is less than the present value of all benefits projected to be payable under the plan during the current plan year and each of the four succeeding plan years (plus administrative expenses).

Rehabilitation Period

The rehabilitation period is the 10-year period beginning on the first day of the first plan year following the earlier of: (1) the second anniversary of the date of adoption of the rehabilitation plan, or (2) the expiration of collective bargaining agreements that were in effect on the due date for the actuarial certification of critical status for the initial critical year and covering at least 75 percent of the active participants in the plan.

The rehabilitation period ends if the plan emerges from critical status. A plan in critical status remains in critical status until a plan year for which the plan actuary certifies that the plan is not projected to have an accumulated funding deficiency for the plan year or any of the nine succeeding plan years, without regard to the use of the shortfall method and taking into account amortization period extensions.

Information to Be Provided to Bargaining Parties

Within 30 days after adoption of the rehabilitation plan, the plan sponsor must provide to the bargaining parties schedules showing revised benefit structures, revised contribution structures, or both which, if adopted, may reasonably be expected to enable the multiemployer plan to emerge from critical status in accordance with the rehabilitation plan.[46] The schedules must reflect reductions in future benefit accruals and adjustable benefits and increases in contributions that the plan sponsor determined are reasonably necessary to emerge from critical status. One schedule must be designated as the default schedule and must assume no increases in contributions other than increases necessary to emerge from critical status after future benefit accruals and other benefits (other than benefits the reduction or elimination of which are not permitted under the anti-cutback rules) have been reduced. The plan sponsor may also provide additional information as appropriate.

Effect and Penalty for Failure to Adopt a Rehabilitation Plan

If a collective bargaining agreement providing for contributions under a multiemployer plan that was in effect at the time the plan entered endangered status expires, and after receiving one of more schedules from the plan sponsor, the bargaining parties fail to adopt a contribution or benefit schedule with terms consistent with the rehabilitation plan and the scheduled from the plan sponsor, the plan sponsor must implement the default schedule. The schedule must be implemented on the earlier of the date: (1) on which the Secretary of Labor certifies that the parties are at an impasse, or (2) which is 180 days after the date on which the collective bargaining agreement expires.

Upon the failure of a plan sponsor to adopt a rehabilitation plan within 240 days after the date required for certification, an ERISA penalty of $1,100 a day applies. In addition, upon the failure to timely adopt a rehabilitation plan, an excise tax is imposed on the plan sponsor equal to the greater of (1) the present law excise tax, or (2) $1,100 per day. The tax must be paid by the plan sponsor.

<u>New Federal Law (IRC section 432)</u>

The provision makes parallel changes to the IRC and ERISA to provide that if a collective bargaining agreement providing for contributions under a multiemployer plan that was in effect at the time entered into endangered status expires, and after receiving one or more schedules from the plan sponsor, the bargaining parties fail to adopt a contribution schedule with terms

[46] A schedule of contribution rates provided by the plan sponsor and relied upon by bargaining parties in negotiating a collective bargaining agreement must remain in effect for the duration of the collective bargaining agreement.

consistent with the funding improvement plan and a schedule from the sponsor, the plan sponsor is required to implement the contribution schedule under the previously-expired collective bargaining agreement 180 days after that collective bargaining agreement's expiration date.

Effective Date

This provision applies with respect to plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[47] including this provision's rules relating to corrective plan schedules.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
108	Repeal of Reorganization Rules for Multiemployer Plans

New Federal Law (IRC sections 401, 418, 418A, 418B, 418C, 418Dm 418E, and 431)

The provision repeals the multiemployer reorganization rules enacted by the Multiemployer Pension Plan Amendments Act of 1980.

[47] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Effective Date

This provision applies with respect to plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[48] including this provision's repeal of reorganization rules for multiemployer plans.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
109	Disregard of Certain Contribution Increases for Withdrawal Liability Purposes

Background

Additional Contributions during Critical Status

In the case of a multiemployer plan in critical status, an additional required contribution ("surcharge") is imposed on employers otherwise obligated to make a contribution in the initial critical year, i.e., the first plan year for which the plan is in critical status. The amount of the surcharge is 5 percent of the contribution otherwise required to be made under the applicable collective bargaining agreement. The surcharge is 10 percent of contributions otherwise required in the case of succeeding plan years in which the plan is in critical status. The surcharge applies 30 days after the employer is notified by the plan sponsor that the plan is in critical status and the surcharge is in effect. The surcharges are due and payable on the same schedule as the contributions on which the surcharges are based. Failure to make the surcharge payment is treated as a delinquent contribution. The surcharge is not required with respect to employees covered by a collective bargaining agreement (or other agreement pursuant to which the employer contributes), beginning on the effective date of a collective bargaining agreement (or other agreement) that includes terms consistent with a schedule presented by the plan sponsor. The amount of the surcharge may not be the basis for any benefit accrual under the plan.

[48] *Ibid.*

Surcharges are disregarded in determining an employer's withdrawal liability, except for purposes of determining the unfunded vested benefits attributable to an employer under ERISA section 4211(c)(4) or a comparable method approved under ERISA section 4211(c)(5).[49]

New Federal Law (IRC section 432)

The provision makes parallel changes to the IRC and ERISA to provide that any additional required contribution ("surcharge") is disregarded for purposes of determining the allocation of unfunded benefits to an employer, and for purposes of determining an employer's withdrawal liability.

Any increase in the contribution rate (or other increases in contribution requirements unless due to increased levels of work, employment, or periods for which compensation is provided) that is required or made in order to enable the plan to meet the requirement of the funding improvement plan is disregarded in determining the allocation of unfunded vested benefits to an employer, except for purposes of determining withdrawal liability calculations. Once a plan emerges from critical or endangered status, increases in the contribution rate are disregarded for purposes of determining the highest contribution rate for plan years in which the plan was in critical or endangered status.

The Pension Benefit Guarantee Corporation is required to prescribe simplified methods for the application of this provision in determining withdrawal liability.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[50] including this provision's disregard of certain contribution increases for withdrawal liability purposes.

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[49] The Pension Benefit Guarantee Corporation is directed to prescribe simplified methods for determining withdrawal liability in this case.

[50] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
201	Contributions, Limitations, Distribution and Notice Requirements, and Approval Process for Benefit Suspensions under Multiemployer Plans in Critical and Declining Status

New Federal Law (IRC section 432)

The provision makes parallel changes to the IRC and to ERISA to provide benefit suspensions for multiemployer plans in critical and declining status.

Suspensions of Benefits

For purposes of this provision, the term "suspension of benefits" means the temporary or permanent reduction of any current or future payment obligation of the plan to any participant or beneficiary under the plan, whether or not in pay status at the time of the suspension of benefits. Any suspension of benefits remains in effect until the earlier of when the plan sponsor provides benefit improvements (as described below) or the suspension of benefits expires by its own terms.

The plan is not liable for any benefit payments not made as a result of a suspension of benefits, and all references to suspension of benefits, increases in benefits, or resumptions of suspended benefits with respect to participants also applies to benefits of beneficiaries or alternative payees of participants.

Critical and Declining Status

A plan is treated as in critical and declining status if the plan is projected to become insolvent during the current plan year or any of the 14 succeeding plan years (19 succeeding plan years if the plan has a ratio of inactive participants to active participants that exceeds 2 to 1 or if the funded percentage of the plan is less than 80 percent.

Conditions for Suspensions

The plan sponsor of a plan in critical and declining status for a plan year may suspend benefits only if, taking into account the proposed suspensions of benefits (and, if applicable, a proposed partition of the plan under section 4233 of ERISA), the plan actuary certifies that the plan is projected to avoid insolvency,[51] assuming the suspension of benefits continue until the suspensions of benefits expire by their own terms or if no such expiration date is set, indefinitely, and the plan sponsor determines, in a written record to be maintained throughout the period of the benefit suspension, that the plan is still projected to become insolvent unless benefits are suspended under this provision, although all reasonable measures to avoid insolvency have been taken (and continue to be taken during the period of benefit suspension).

In its determination, the plan sponsor may take into account factors including current and past contribution levels, levels of benefit accruals (including any prior reductions in the rate of benefit accruals), prior reductions (if any) of adjusted benefits, prior suspensions (if any) of benefits under this provision, the impact on plan solvency of the subsidies and ancillary benefits available to active participants, compensation levels of active participants relative to employees in the participants' industry generally, competitive and other economic factors facing contributing employees, the impact of benefit and contribution levels on retaining active participants and bargaining groups under the plan, the impact of past and anticipated contribution increases under the plan on employer attrition and retention levels, and measure undertaken by the plan sponsor to retain or attract contributing employees.

Limitations on Suspensions

Any suspensions of benefits made by a plan sponsor pursuant to this provision may generally not be reduced below 110 percent of the monthly benefit that is guaranteed by the Pension Benefit Guaranty Corporation. However, if a participant or beneficiary has attained age 75 as of the effective date of the suspension, the percentage of the maximum suspended benefits of such participant or beneficiary is the number of months during the period beginning with the month after the month in which the effective date of suspension occurs and ending with the month during which the participant or beneficiary attains age 80, divided by 60 months. No benefits of participants or beneficiaries who are over age 80 may be suspended, and no benefits based on disability may be suspended.

Any suspension of benefits, in the aggregate (and, if applicable, considered in combination with a partition of the plan under section 4233 of the Employee Retirement Income Security Act of 1974 (ERISA) are required to be reasonably estimated to achieve, but not materially exceed, the level necessary to avoid insolvency. If a suspension of benefits with respect to a plan is made in combination with a partition of the plan under section 4233 of ERISA, the suspension of benefits may not take effect prior to the effective date of such partition.

Any suspension of benefits is required to be equitably distributed across the participant and benefit population, taking into account factors with respect to participants and beneficiaries and their benefits, that may include age and life expectancy, length of time in pay status, amount of benefit, type of benefit (i.e., survivor, normal retirement, or early retirement), extent to which participant or beneficiary has received post-retirement benefit increases, history of benefit increases and reductions, years to retirement for active employees, any discrepancies active and

[51] Within the meaning of IRC section 418E.

retiree benefits, extent to which active participants are reasonably likely to withdraw support for the plan, accelerating employer withdrawals from the plan and increasing the risk of additional benefit reductions for participants in and out of pay status, and extent to which benefits are attributed to service with an employer that failed to pay its full withdrawal liability.

Benefit suspension ordering rules apply in the case of benefits attributable to a participant's service with any employer prior to the 1974 enactment of ERISA.

Retiree Representative

In the case of a plan with 10,000 or more participants, the plan sponsor is required to select a participant of the plan in pay status to act as a retiree representative not later than 60 days prior to submitting an application to suspend benefits. The retiree representative is required to advocate for the interests of the retired and deferred vested participants and beneficiaries of the plan throughout the suspension approval process. The plan is required to provide for reasonable expenses by the retiree representative, including reasonable legal and actuarial support, commensurate with the plan's size and funding status.

Benefit Improvements

The plan sponsor may, it its sole discretion, provide benefit improvements while any suspension of benefits under the plan remains in effect, except that the plan sponsor may not increase the liabilities of the plan by reason of any benefit improvement for any participant or beneficiary not in pay status by the for day of the plan year for which the benefit improvement takes effect unless such action is accompanied by equitable benefit improvements (described below) for all participants and beneficiaries whose benefit commencement dates were before the first day of the plan year for winch the benefit improvement fur such participant or beneficiary took effect and the plan actuary certifies that after taking into account such benefit improvements the plan is projected to avoid insolvency indefinitely.

Equitable Distribution of Benefit Improvements

The projected value of total liabilities for benefit improvements for participants and beneficiaries not in pay status by the date of the first day of the plan year in which the benefit improvements are proposed to take effect, as determined as of such date, may not exceed the projected value of liabilities arising from benefit improvements for participants and beneficiaries with benefit commencement dates prior to the first day of such plan year.

The plan sponsor is required to equitably distribute any increase in total liabilities for benefit improvements to some or all of the participants and beneficiaries whose benefit commencement date is before the date of the first day of the plan year in which the benefit improvements are proposed to take effect, taking into account the relevant factors described above in "Conditions for Suspensions" and to the extent to which the benefits of the participants and the beneficiaries were suspended.

The plan sponsor may increase liabilities of the plan through a resumption of benefits for participants and beneficiaries in pay status only if the plan sponsor equitably distributes the value of resumed benefits to some or all of the participants and beneficiaries in pay status, taking into account the relevant factors described above in "Conditions for Suspensions."

Benefit increases for participants and beneficiaries not in pay status are allowed if they are reasonable and result in only de minimis increases in the liabilities of the plan, or if such increases are required for purposes of qualification of the plan. Except for the special rules for resumption of benefits only for participants in pay status, the limitations on benefit improvements while a suspension of benefits is in effect is in addition to any other applicable limitations on increases in benefits imposed on plan.

For purposes of this provision, the term "benefit improvement" means, with respect to a plan, a resumption of suspended benefits, an increase in benefits, an increase in the rate at which benefits accrue, or an increase in the rate at which benefits become nonforfeitable under the plan.

Notice Requirements

In General

No suspension of benefits may be made unless notice of the proposed suspension has been given to the plan sponsor concurrently with an application for approval of such suspension submitted to the Secretary of the Treasury to the plan participants and beneficiaries who may be contacted by reasonable efforts, each employer who has an obligation to contribute under the plan, and each employee organization which, for purposes of collective bargaining, represents plan participants employed by such an employer.

Content of Notice

The notice is required to contain sufficient information to enable the plan participants and beneficiaries to understand the effect of any suspension of benefits, including an individualized estimate (on an annual or monthly basis) of such effect on each participant or beneficiary, a description of the factors considered by the plan sponsor in designing the benefit suspensions, a statement that the application for approval of any suspension of benefits is required to be available on the website of the Department of the Treasury and that comments on that application will be accepted, information as to the rights and remedies of plan participants and beneficiaries, a statement describing the appointment of a retiree representative (if applicable), identifying information about such retiree representative (including whether the representative is a plan trustee), and how to contact such representative, and the information on how to contact the Department of Treasury for further information and assistance where appropriate.

Approval Process

The plan sponsor of a plan in critical and declining status for a plan year that seeks to suspend benefits must submit an application to the Secretary of the Treasury for approval of the suspension of benefits. The Secretary of the Treasury is required to approve, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, an application for approval of suspension of benefits upon finding that the plan is eligible for suspension and satisfied the conditions for suspension, limitation rules, equitable distribution rules, and notice requirements.

The Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, is required to publish a notice in the Federal Register within 30 days after the receipt of the application for suspension of benefits soliciting comments from contributing employers, employee organizations, and participants and beneficiaries of the plan for which an application was made and other interested parties. The application for approval of suspension of benefits is required to be published on the website of the Department of the Treasury.

Required Action; Deemed Approval

The Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, is required to approve or deny any application for suspension of benefits within 225 days after the submission of the application. An application for suspension of benefits will be deemed approved unless the Secretary of the Treasury notifies the plan sponsor that the application has failed to satisfy one or more of the applicable requirements. If the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, rejects a plan sponsor's application, the Secretary of the Treasury is required to provide notice to the plan sponsor detailing the specific reasons for the rejection, including reference to the specific requirement not satisfied.

Participant Ratification Process

No suspension of benefits may take effect prior to a vote of the participants and beneficiaries of the plan with respect to the suspension. The Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, shall administer a vote of participants and beneficiaries of the plan within 30 days after approval of the suspension. The plan sponsor may submit a new suspension application to the Secretary of the Treasury for approval in any case in which a suspension is prohibited from taking effect pursuant to a vote.

The plan sponsor is required to provide a ballot for the vote that includes a statement from the plan sponsor in support of the suspension, a statement in opposition to the suspension complied from comments received, a statement that the suspension has been approved by the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, a statement that the plan sponsor has determined that the plan will become insolvent unless the suspension takes effect, a statement that insolvency of the plan could result in benefits lower than benefits paid under the suspension, and a statement that the insolvency of the Pension Benefit Guaranty Corporation would result in benefits lower that paid in the case of plan insolvency.

Systemically Important Plans

In General

Within 14 days after a vote rejecting a suspension, the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, is required to determine whether the plan is a systemically important plan. If a plan is determined to be a systemically important plan, within 90 days of the date the results of the vote are certified, the Secretary of the Treasury is allowed to implement the suspension proposed by the plan sponsor, or permit the implementation of a modification by the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, of the suspension (so long as the plan is projected to avoid insolvency).

Within 30 days after a determination of the Secretary of the Treasury, in consultation with the Pension Benefit Guaranty Corporation and the Secretary of Labor, that the plan is systemically important, the Participant and the Participant Sponsor Advocate[52] may submit recommendations to the Secretary of the Treasury with respect to the suspension or any revisions to the suspension.

Systemically Important Plan Defined

A systemically important plan is a plan with respect to which the Pension Benefit Guaranty Corporation projects the present value of projected financial payments assistance to exceed $1 billion if suspensions are not limited.

Effective Date

This provision is effective on December 16, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[53] including this provision relating to suspension of benefits.

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[52] The Participant and the Participant Sponsor Advocate selected under section 4004 of the Employee Retirement Income Security Act of 1974 (ERISA).

[53] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
2	Clarification of the Normal Retirement Age

Background

Age Discrimination Rules in General

Under the Pension Protection Act of 2006, a defined benefit plan is not treated as violating the prohibition on age discrimination under ERISA and the IRC if a participant's accrued benefit,[54] as determined as of any date under the terms of the plan, would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant. For this purpose, an individual is similarly situated to a participant if the individual and the participant are (and always have been) identical in every respect (including period of service, compensation, position, date of hire, work history, and any other respect) except for age. The comparison of benefits for older and younger participants applies to all possible participants under all possible dates under the plan, in the same manner as the present-law application of the back-loading and accrual rules.

In addition, in determining a participant's accrued benefit for this purpose, the subsidized portion of any early retirement benefit or any retirement type subsidy is disregarded. In some cases the value of an early retirement subsidy may be difficult to determine; it is therefore intended that a reasonable approximation of such value may be used for this purpose. In calculating the accrued benefit, the benefit may, under the terms of the plan, be calculated as an annuity payable at normal retirement age, the balance of a hypothetical account, or the current value of the accumulated percentage of the employee's final average compensation. That is, the age discrimination rules may be applied on the basis of the balance of a hypothetical account or the current value of the accumulated percentage of the employee's final average compensation, but only if the plan terms provide the accrued benefit in such form. The provision is intended to apply to hybrid plans, including pension equity plans.

The provision makes it clear that a plan is not treated as age discriminatory solely because the plan provides offsets of benefits under the plan to the extent such offsets are allowable in applying the requirements under IRC section 401(a).

A plan is not treated as failing to meet the age discrimination requirements solely because the plan provides a disparity in contributions and benefits with respect to which the requirements of IRC section 401(l) are met.

A plan is not treated as failing to meet the age discrimination requirements solely because the plan provides for indexing of accrued benefits under the plan. Except in the case of any benefit provided in the form of a variable annuity, this rule does not apply with respect to any indexing

[54] For purposes of this rule, the accrued benefit means such benefit accrued to date.

which results in an accrued benefit less than the accrued benefit determined without regard to such indexing. In no event may indexing be reduced or cease because of age.

The Cooperative and Small Employer Charity Pension Flexibility Act

The Cooperative and Small Employer Charity Pension Flexibility Act, enacted April 7, 2014, made parallel amendments to the IRC and ERISA to define a "cooperative and small employer charity pension plan" (CSEC pension plan) as an employee pension benefit plan that is a defined benefit pension plan: (1) to which certain provisions of the Pension Protection Act of 2006 apply; or (2) that, as of June 25, 2010, was maintained by more than one employer all of whom were tax-exempt charitable organizations.

Minimum funding standards are established for CSEC pension plans, and allow a CSEC plan that uses a funding method that requires contributions in all years to maintain an alternative minimum funding standard account for any plan year. The Secretary of the Treasury is permitted to extend an amortization of any unfunded liability of a CSEC pension plan for up to 10 years if the Secretary determines that: (1) such extension would carry out the purposes of this Act and would provide adequate protection for plan participants and their beneficiaries, and (2) failure to permit such extension would result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation.

The Act also sets forth rules for valuation of CSEC pension plan assets, allowable contributions, and plan liquidity, and imposes a lien in favor of a CSEC plan for failure to make required contributions. The Secretary of the Treasury is authorized to prescribe mortality tables to determine current liability of CSEC plans. A CSEC plan sponsor is required to establish a written funding restoration plan within 180 days after receipt of a certification from the plan actuary that the plan is in funding restoration status for a plan year.

<u>New Federal Law (IRC section 411)</u>

This provision makes parallel changes to the IRC and ERISA to provide a special rule for determining normal retirement age for certain defined benefit plans. A defined benefit plan the terms of which, on or before December 8, 2014, provided for a normal retirement age that is the earlier of the normal retirement age[55] or the age at which a participant completes the number of years (not less than 30 years) of benefit accrual specified by the plan, is not treated as failing to meet any plan requirements solely because the plan provides such a normal retirement age.

<u>Effective Date</u>

This provision applies to all periods before, on, and after December 19, 2014.

[55] The normal retirement age under IRC section 411(a) means the earlier of the time a plan participant attains normal retirement age under the plan, or the later of the time a plan participant attains age 65 or the fifth anniversary of the time a plan participant commenced participation in the plan.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[56] including this provision to provide a special rule for determining normal retirement age for certain defined benefit plans.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
3	Application of Cooperative and Small Employer Charity Pension Plan Rules to Certain Charitable Employers Whose Primary Purpose is Providing Services with Respect to Children

Background

The Cooperative and Small Employer Charity Pension Flexibility Act

The Cooperative and Small Employer Charity Pension Flexibility Act, enacted April 7, 2014, made parallel amendments to the IRC and ERISA to define a "cooperative and small employer charity pension plan" (CSEC pension plan) as an employee pension benefit plan that is a defined benefit pension plan: (1) to which certain provisions of the Pension Protection Act of 2006 apply; or (2) that, as of June 25, 2010, was maintained by more than one employer all of whom were tax-exempt charitable organizations.

[56] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the “specified date” contained in R&TC section 17024.5.

Minimum funding standards are established for CSEC pension plans, and allow a CSEC plan that uses a funding method that requires contributions in all years to maintain an alternative minimum funding standard account for any plan year. The Secretary of the Treasury is permitted to extend an amortization of any unfunded liability of a CSEC pension plan for up to 10 years if the Secretary determines that: (1) such extension would carry out the purposes of this Act and would provide adequate protection for plan participants and their beneficiaries, and (2) failure to permit such extension would result in a substantial risk to the voluntary continuation of the plan or a substantial curtailment of pension benefit levels or employee compensation.

The Act also sets forth rules for valuation of CSEC pension plan assets, allowable contributions, and plan liquidity, and imposes a lien in favor of a CSEC plan for failure to make required contributions. The Secretary of the Treasury is authorized to prescribe mortality tables to determine current liability of CSEC plans. A CSEC plan sponsor is required to establish a written funding restoration plan within 180 days after receipt of a certification from the plan actuary that the plan is in funding restoration status for a plan year.

New Federal Law (IRC section 414)

This provision makes parallel changes to the IRC and ERISA to provide that a CSEC plan additionally includes a defined benefit plan (other than a multiemployer plan) that, as of June 25, 2010, was maintained by a tax-exempt employer[57] with employees in at least 40 states and whose primary purpose is to provide services with respect to children.

Effective Date

This provision applies as if included in the amendments made by the Cooperative and Small Employer Charity Pension Flexibility Act.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[58] including this provision relating to treating plans of certain tax-exempt employers as CSEC plans.

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[57] Described in IRC section 501(c)(3), relating to list of exempt organizations.

[58] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

ERISA Preemption

Additionally, federal ERISA provisions specifically preempt state laws relating to certain employee benefit plans in California.

Impact on California Revenue

Baseline.

Section	Section Title
1	Rollover of Amounts Received in Airline Carrier Bankruptcy

Background

In General

The IRC provides for two types of individual retirement arrangements (IRAs): traditional IRAs and Roth IRAs.[59] In general, contributions (other than a rollover contribution) to a traditional IRA may be deductible, and distributions from a traditional IRA are includible in gross income to the extent not attributable to a return of nondeductible contributions. In contrast, contributions to a Roth IRA are not deductible, and qualified distributions from a Roth IRA are excludable from gross income. Distributions from a Roth IRA that are not qualified distributions are includible in gross income to the extent attributable to earnings. In general, a qualified distribution is a distribution that is made on or after the individual attains age 59½, death, disability, or which is a qualified special purpose distribution.

The total amount that an individual may contribute to one or more IRAs for a year is generally limited to the lesser of: (1) a dollar amount ($5,500 for 2014 (or $6,500 for 2014 if age 50 or older)), or (2) the amount of the individual's compensation that is includible in gross income for the year. As under the rules relating to traditional IRAs, a contribution of up to the dollar limit for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with adjusted gross income for the taxable year over certain indexed levels. The adjusted gross income phase-out ranges for 2014 are: (1) for single taxpayers, $114,000 to $129,000; (2) for married taxpayers filing joint returns, $181,000 to $191,000; and (3) for married taxpayers filing separate returns, $0 to $10,000.

The foregoing contribution limitations for IRAs do not apply in the case of a rollover contribution to an IRA. If certain requirements are satisfied, a participant in an employer-sponsored qualified plan (which includes a tax-qualified retirement plan described in IRC section 401(a), an employee retirement annuity described in IRC section 403(a), a tax-sheltered annuity described in IRC section 403(b), and a governmental IRC section 457(b) plan) or a traditional IRA may roll over distributions from the plan, annuity or IRA into another plan, annuity or IRA.

2008 Provision Specifically for Airline Employees

Under an uncodified provision of the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA),[60] a qualified airline employee may contribute any portion of an airline payment amount

[59] Traditional IRAs are described in IRC section 408, and Roth IRAs are described in IRC section 408A.

[60] Section 125 of Public Law 110-458, December 23, 2008.

to a Roth IRA within 180 days of receipt of such amount (or, if later, within 180 days of December 23, 2008). Such a contribution is treated as a qualified rollover contribution to the Roth IRA. Thus, the portion of the airline payment amount contributed to the Roth IRA is includible in gross income to the extent that such payment would be includible were it not part of the rollover contribution.

Under this provision, an airline payment amount is defined as any payment of any money or other property payable by a commercial passenger airline to a qualified airline employee: (1) under the approval of an order of a federal bankruptcy court in a case filed after September 11, 2001, and before January 1, 2007, and (2) in respect of the qualified airline employee's interest in a bankruptcy claim against the airline carrier, any note of the carrier (or amount paid in lieu of a note being issued), or any other fixed obligation of the carrier to pay a lump-sum amount. An airline payment amount shall not include any amount payable on the basis of the carrier's future earnings or profits. In determining the amount that may be contributed to a Roth IRA under this provision, any reduction in the airline payment amount on account of employment tax withholding is disregarded. A qualified airline employee is an employee or former employee of a commercial passenger airline carrier who was a participant in a defined benefit plan maintained by the carrier that: (1) is qualified under IRC section 401(a); and (2) was terminated or became subject to the benefit accrual and other restrictions applicable to plans maintained by commercial passenger airlines pursuant to paragraphs 402(b)(2) and (3) of the Pension Protection Act of 2006.[61]

2012 Provision Specifically for Airline Employees

Under an uncodified provision of the FAA Modernization and Reform Act of 2012,[62] a qualified airline employee may contribute up to 90 percent of an airline payment amount to a traditional IRA. This provision also allows qualified airline employees who previously transferred an airline payment amount into a Roth IRA (under the WRERA provision) to transfer such payment from the Roth IRA to a traditional IRA, subject to the 90-percent limit.

Transfers made to a traditional IRA are excluded from income, and if an employee previously included any such transferred amount in income, an amended return may be flied to claim a refund (for the taxable year the payment was received). This provision modifies that statute of limitations for filing an amended return to claim a refund for such a transfer to the later of the normal statute of limitations or April 15, 2013.

<u>New Federal Law (Uncodified Act Section 1 Affecting IRC sections 402 and 408)</u>

This provision extends the period for filing a claim for refund of an overpayment of tax resulting from rollovers to a traditional or Roth individual retirement account (IRA) of airline payments to qualified airline employees in commercial airline carrier bankruptcy cases, to the later of April 15, 2015, or the expiration of the limitation period for filing refund claims, modifies the definition of "airline payment amount" to include payments in an airline carrier bankruptcy case

[61] Public Law 109-280, August 17, 2006.

[62] Section 1106 of Title XI of Public Law 112-95, February 14, 2012.

filed after September 11, 2001, and before January 1, 2007, or on November 29, 2011, and modifies the definition of "qualified airline employee" to include an employee who was a participant in a defined benefit plan maintained by an airline carrier that was frozen effective November 1, 2012.

Effective Date

This provision is effective December 18, 2014.

California Law (R&TC section 17501)

The federal uncodified changes that allow qualified airline employees to make IRA contributions of airline payment amounts, and transfers of previous airline payment amounts from a Roth IRA to a traditional IRA, automatically apply under California law without regard to taxable year to the same extent as applicable for federal income tax purposes.[63]

California law does not conform to this provision's change to the IRC that extends the federal statute of limitations for filing an amended return to claim a refund based on a transfer from a Roth IRA to a traditional IRA; however, California law provides that an amended return to claim a refund that is based on a federal change may be filed within two years from the date of the final federal determination.[64]

Impact on California Revenue

Baseline.

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[63] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

[64] R&TC section 19311.

Section	Section Title
101	Extension of Deduction for Certain Expenses of Elementary and Secondary School Teachers

Background

In general, ordinary and necessary business expenses are deductible. However, unreimbursed employee business expenses generally are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous deductions (including employee business expenses) exceed two percent of adjusted gross income. An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of a threshold amount. In addition, miscellaneous itemized deductions are not allowable under the alternative minimum tax.

Certain expenses of eligible educators are allowed as an above-the-line deduction. Specifically, for taxable years beginning prior to January 1, 2014, an above-the-line deduction is allowed for up to $250 annually of expenses paid or incurred by an eligible educator for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by the eligible educator in the classroom.[65] To be eligible for this deduction, the expenses must be otherwise deductible under IRC section 162 as a trade or business expense. A deduction is allowed only to the extent the amount of expenses exceeds the amount excludable from income under IRC section 135 (relating to education savings bonds), IRC section 529(c)(1) (relating to qualified tuition programs), and IRC section 530(d)(2) (relating to Coverdell education savings accounts).

An eligible educator is a kindergarten-through-grade-twelve teacher, instructor, counselor, principal, or aide in a school for at least 900 hours during a school year. A school means any school that provides elementary education or secondary education (kindergarten through grade 12), as determined under state law.

The above-the-line deduction for eligible educators is not allowed for taxable years beginning after December 31, 2013.

New Federal Law (IRC section 62)

The provision extends the deduction for eligible educator expenses for one year so that it is available for taxable years beginning before January 1, 2015.

[65] IRC section 62(a)(2)(D).

Effective Date

The provision is effective for taxable years beginning after December 31, 2013.

California Law (R&TC section 17072)

The Personal Income Tax Law specifically does not conform to the above-the-line deduction for certain expenses of elementary and secondary school teachers.[66] As a result, any amount that teachers deduct on their federal tax returns as "educator expenses" must be added back on their California tax returns by reporting this as a California adjustment on Schedule CA (540/540NR).

Impact on California Revenue

Not applicable.

Section	Section Title
102	Extension of Exclusion from Gross Income of Discharge of Qualified Principal Residence Indebtedness

Background

In General

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, and certain real property business indebtedness.[67] In cases involving discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge.[68]

[66] R&TC section 17072(b).

[67] IRC sections 61(a)(12) and 108.

[68] IRC section 1017.

For all taxpayers, the amount of discharge of indebtedness generally is equal to the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt. These rules generally apply to the exchange of an old obligation for a new obligation, including a modification of indebtedness that is treated as an exchange (a debt-for-debt exchange).

Qualified Principal Residence Indebtedness

An exclusion from gross income is provided for any discharge of indebtedness income by reason of a discharge (in whole or in part) of qualified principal residence indebtedness. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of IRC section 163(h)(3)(B), except that the dollar limitation is $2,000,000) with respect to the taxpayer's principal residence. Acquisition indebtedness with respect to a principal residence generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and is secured by the residence. It also includes refinancing of such indebtedness to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. For these purposes, the term "principal residence" has the same meaning as under IRC section 121.

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt which is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of $1 million, of which $800,000 is qualified principal residence indebtedness. If the residence is sold for $700,000 and $300,000 debt is discharged, then only $100,000 of the amount discharged may be excluded from gross income under the qualified principal residence indebtedness exclusion.

The basis of the individual's principal residence is reduced by the amount excluded from income under the provision.

The qualified principal residence indebtedness exclusion does not apply to a taxpayer in a Title 11 case; instead the general exclusion rules apply. In the case of an insolvent taxpayer not in a Title 11 case, the qualified principal residence indebtedness exclusion applies unless the taxpayer elects to have the general exclusion rules apply instead.

The exclusion does not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

The exclusion for qualified principal residence indebtedness is effective for discharges of indebtedness occurring before January 1, 2014.

<u>New Federal Law (IRC section 108)</u>

The provision extends the exclusion for qualified principal residence indebtedness for one year, for discharges of indebtedness occurring before January 1, 2015.

Effective Date

This provision applies to indebtedness discharged after December 31, 2013.

California Law (R&TC sections 17071 and 17144.5)

The Personal Income Tax Law generally conforms to the federal definition of gross income, and conforms to the federal rules for the exclusion of discharge-of-indebtedness income by reason of a discharge of qualified principal residence indebtedness (i.e., mortgage forgiveness debt relief), with the following modifications:

A. The exclusion does not apply to discharges occurring in 2014:

    - The California exclusion applies to discharges occurring on or after January 1, 2007, and before January 1, 2014.
    - The federal exclusion applies to discharges occurring on or after January 1, 2007, and before January 1, 2015.

B. The maximum amount of qualified principal residence indebtedness (i.e., the amount of principal residence indebtedness eligible for the exclusion) is reduced:

    - The California maximum amount of qualified principal residence indebtedness is $800,000 ($400,000 in the case of a married individual/registered domestic partner (RDP) filing a separate return).
    - The federal maximum amount of qualified principal residence indebtedness is $2,000,000 ($1,000,000 in the case of a married individual/RDP filing a separate return).

C. The total amount that may be excluded from gross income is limited.

    - For discharges occurring in 2007 or 2008, California limits the total amount that may be excluded from gross income to $250,000 ($125,000 in the case of a married individual/RDP filing a separate return).
    - For discharges occurring in 2009, 2010, 2011, 2012, or 2013, California limits the total amount that may be excluded from gross income to $500,000 ($250,000 in the case of a married individual/RDP filing a separate return).
    - There is no comparable federal limitation in any year.

D. Interest and penalties are not imposed with respect to 2007, 2009, or 2013 discharges.

    - California prohibits the imposition of any interest or penalties with respect to discharges of qualified principal residence that occurred during the 2007, 2009, or 2013 taxable years.
    - There is no comparable federal prohibition.

If the amount of forgiven mortgage debt that is excludable for federal purposes is more than the amount excludable under California law, taxpayers report the difference as a California adjustment on Schedule CA (540/540NR). Additionally, taxpayers who exclude cancellation of indebtedness income for California purposes are required to file a copy of their federal returns including Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), with their California returns.

Impact on California Revenue

None (the federal provision expired for discharges occurring on or after January 1, 2015).

Section	Section Title
103	Extension of Parity for Employer-Provided Mass Transit and Parking Benefits

Background

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income for income tax purposes and from an employee's wages for employment tax purposes.[69] Qualified transportation fringe benefits include parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements. No amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and qualified transportation fringe benefits (other than a qualified bicycle commuting reimbursement). Qualified transportation fringe benefits also include a cash reimbursement (under a bona fide reimbursement arrangement) by an employer to an employee for parking, transit passes, or vanpooling. In the case of transit passes, however, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher, or similar item that may be exchanged only for a transit pass, is not readily available for direct distribution by the employer to the employee.

Before February 17, 2009, the amount that could be excluded as qualified transportation fringe benefits was limited to $100 per month in combined transit pass and vanpool benefits and $175 per month in qualified parking benefits. These limits are adjusted annually for inflation, using 1998 as the base year; for 2014 the limits are $130 and $250, respectively. The American Recovery and Reinvestment Act of 2009[70] provided parity in qualified transportation fringe benefits by temporarily increasing the monthly exclusion for combined employer-provided transit pass and vanpool benefits to the same level as the exclusion for employer-provided parking, effective for months beginning on or after the date of enactment (February 17, 2009) and before January 1, 2011. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act

[69] IRC sections 132(a)(5) and (f), 3121(a)(20), 3231(e)(5), 3306(b)(16), and 3401(a)(19).

[70] Section 1151 of Public Law 111-5.

of 2010[71] extended parity in qualified transportation fringe benefits through December 31, 2011. The American Taxpayer Relief Act of 2012[72] extended parity in qualified transportation fringe benefits through December 31, 2013.

Effective January 1, 2014, the amount that can be excluded as qualified transportation fringe benefits is limited to $130 per month in combined transit pass and vanpool benefits and $250 per month in qualified parking benefits.

New Federal Law (IRC section 132)

The provision extends parity in qualified transportation fringe benefits through December 31, 2014. Thus, for 2014, the monthly limit on the exclusion for combined transit pass and vanpool benefits is $250.

Effective Date

The provision is effective for months after December 31, 2013.

California Law (R&TC sections 17131 and 17149)

The Personal Income Tax Law generally conforms to the federal rules for items specifically excluded from gross income as of the "specified date" of January 1, 2009,[73] and as a result conforms to the federal exclusion for qualified transportation fringe benefits under IRC section 132 as of that "specified date." However, the Personal Income Tax Law additionally provides its own exclusion for qualified California transportation fringe benefits,[74] and this exclusion under state law is not subject to any limitation; thus, while California does not conform to the parity in qualified transportation fringe benefits that is being extended by this provision, the enhanced exclusion is allowable under current California law to the extent that the benefits are qualified California transportation benefits.

Impact on California Revenue

Baseline—although California does not conform to this provision because it was enacted after the "specified date," California's Personal Income Tax Law allows an unlimited exclusion for qualified California transportation fringe benefits.[75] Thus, because some employers are expected to

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[71] Section 727 of Public Law 111-312.

[72] Section 203 of Public Law 112-240.

[73] R&TC section17131 conforms to Part III of Subchapter B of Chapter 1 of Subtitle A of the IRC, containing IRC sections 101 to 138, as of the "specified date" of January 1, 2009, with modifications.

[74] R&TC section 17149.

[75] If taxpayers have qualified California transportation fringe benefits that are excludable for state purposes, but not excludable for federal purposes because of the federal limitations, they report the state-only excludable amounts as California adjustments on Schedule CA (540/540NR).

change the amount of transportation fringe benefits offered based on this federal extension of parity of qualified transportation fringe benefits, this provision is estimated to result in a baseline revenue loss.

Section	Section Title
104	Extension of Mortgage Insurance Premiums Treated as Qualified Residence Interest

Background

In General

Present law provides that qualified residence interest is deductible, notwithstanding the general rule that personal interest is nondeductible.[76]

Acquisition Indebtedness and Home Equity Indebtedness

Qualified residence interest is interest on acquisition indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of acquisition indebtedness is $1 million. The maximum amount of home equity indebtedness is $100,000. Acquisition indebtedness means debt that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer, and that is secured by the residence. Home equity indebtedness is debt (other than acquisition indebtedness) that is secured by the taxpayer's principal or second residence, to the extent the aggregate amount of such debt does not exceed the difference between the total acquisition indebtedness with respect to the residence, and the fair market value of the residence.

Private Mortgage Insurance

Certain premiums paid or accrued for qualified mortgage insurance by a taxpayer during the taxable year in connection with acquisition indebtedness on a qualified residence of the taxpayer are treated as interest that is qualified residence interest and thus deductible under federal law.[77]

The amount allowable as a deduction is phased out ratably by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000 ($500 and $50,000, respectively, in the case of a married individual filing a separate return). Thus, the deduction is not allowed if the taxpayer's adjusted gross income exceeds $110,000 ($55,000 in the case of married individual filing a separate return).

[76] IRC section 163(h)(3).

[77] IRC section 163(h)(3)(E).

For this purpose, qualified mortgage insurance means mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (defined in section two of the Homeowners Protection Act of 1998, as in effect on December 20, 2006).

Amounts paid for qualified mortgage insurance that are properly allocable to periods after the close of the taxable year are treated as paid in the period to which they are allocated. No deduction is allowed for the unamortized balance if the mortgage is paid before its term (except in the case of qualified mortgage insurance provided by the Department of Veterans Affairs or the Rural Housing Service).

The provision does not apply with respect to any mortgage insurance contract issued before January 1, 2007.

The provision terminates for any amount paid or accrued after December 31, 2013, or properly allocable to any period after that date.

Reporting rules apply under the provision.

New Federal Law (IRC section 163)

The provision extends the deduction for private mortgage insurance premiums for one year, through 2014 (with respect to contracts entered into after December 31, 2006). Thus, the provision applies to amounts paid or accrued in 2014 (and not properly allocable to any period after 2014).

Effective Date

The provision is effective for amounts paid or accrued after December 31, 2013.

California Law (R&TC section 17225)

The Personal Income Tax Law specifically does not conform to the federal deduction for private mortgage insurance premiums. As a result, private mortgage insurance premiums are not deductible under California law, and taxpayers who deduct such premiums on their federal tax returns report the amount deducted for federal purposes as a California adjustment on Schedule CA (540/540NR).

Impact on California Revenue

Not applicable.

Section	Section Title
105	Extension of Deduction of State and Local General Sales Taxes

Background

For purposes of determining regular tax liability, an itemized deduction is permitted for certain state and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. The itemized deduction is not permitted for purposes of determining a taxpayer's alternative minimum taxable income. For taxable years beginning before 2014, at the election of the taxpayer, an itemized deduction may be taken for state and local general sales taxes in lieu of the itemized deduction provided under present law for state and local income taxes. As is the case for state and local income taxes, the itemized deduction for state and local general sales taxes is not permitted for purposes of determining a taxpayer's alternative minimum taxable income.

Taxpayers have two options with respect to the determination of the sales tax deduction amount. Taxpayers may deduct the total amount of general state and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary of the Treasury that show the allowable deduction. The tables are based on average consumption by taxpayers on a state-by-state basis taking into account number of dependents, modified adjusted gross income, and rates of state and local general sales taxation. Taxpayers who live in more than one jurisdiction during the tax year are required to pro-rate the table amounts based on the time they live in each jurisdiction. Taxpayers who use the tables created by the Secretary of the Treasury may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats, and other items specified by the Secretary of the Treasury. Sales taxes for items that may be added to the tables are not reflected in the tables themselves.

A general sales tax is a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items.[78] No deduction is allowed for any general sales tax imposed with respect to an item at a rate other than the general rate of tax. However, in the case of food, clothing, medical supplies, and motor vehicles, the above rules are relaxed in two ways. First, if the tax does not apply with respect to some or all of such items, a tax that applies to other such items can still be considered a general sales tax. Second, the rate of tax applicable with respect to some or all of these items may be lower than the general rate. However, in the case of motor vehicles, if the rate of tax exceeds the general rate, such excess is disregarded and the general rate is treated as the rate of tax.

A compensating use tax with respect to an item is treated as a general sales tax, provided such tax is complementary to a general sales tax and a deduction for sales taxes is allowable with respect to items sold at retail in the taxing jurisdiction that are similar to such item.

[78] IRC section 164(b)(5)(B).

New Federal Law (IRC section 164)

The provision allowing taxpayers to elect to deduct state and local sales taxes in lieu of state and local income taxes is extended for one year, through December 31, 2014.

Effective Date

The provision applies to taxable years beginning after December 31, 2013.

California Law (R&TC section 17220)

The Personal Income Tax Law specifically does not conform to the federal deduction allowed for state and local sales taxes.[79]

Impact on California Revenue

Not applicable.

Section	Section Title
106	Extension of Special Rule for Contributions of Capital Gain Real Property Made for Conservation Purposes

Background

Charitable Contributions Generally

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.[80]

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks. Total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private non-operating foundations generally may not exceed 50 percent of the

[79] R&TC section 17220(b).

[80] IRC sections 170, 2055, and 2522, respectively.

taxpayer's contribution base, which is the taxpayer's adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation: (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base; (2) contributions of cash to most private non-operating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer's contribution base; and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer's contribution base.

Contributions in excess of the applicable percentage limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

Capital Gain Property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Contributions of capital gain property to charitable organizations described in IRC section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30 percent of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in IRC section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20 percent of the taxpayer's contribution base.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions.

Qualified Conservation Contributions

Qualified conservation contributions are one exception to the ''partial-interest'' rule, which generally bars deductions for charitable contributions of partial interests in property.[81] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property.

Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations.

[81] IRC sections 170(f)(3)(B)(iii) and 170(h).

Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated federal, state, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules as other charitable contributions of capital gain property.

Temporary Rules Regarding Contributions of Capital Gain Real Property for Conservation Purposes

In General

Under a temporary provision,[82] the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions (as defined under present law). Instead, individuals may deduct the fair market value of any qualified conservation contribution to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years.

For example, assume an individual with a contribution base of $100 makes a qualified conservation contribution of property with a fair market value of $80 and makes other charitable contributions subject to the 50-percent limitation of $60. The individual is allowed a deduction of $50 in the current taxable year for the non-conservation contributions (50 percent of the $100 contribution base) and is allowed to carry over the excess $10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire $80 qualified conservation contribution may be carried forward for up to 15 years.

Farmers and Ranchers

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

In the above example, if the individual is a qualified farmer or rancher, in addition to the

[82] IRC section 170(b)(1)(E).

$50 deduction for non-conservation contributions, an additional $50 for the qualified conservation contribution is allowed and $30 may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under IRC section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[83]

As an additional condition of eligibility for the 100-percent limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remains generally available for such production. (There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.)

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of IRC section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Termination

The temporary rules regarding contributions of capital gain real property for conservation purposes do not apply to contributions made in taxable years beginning after December 31, 2013.[84]

New Federal Law (IRC section 170)

The provision extends the special rule regarding contributions of capital gain real property for conservation purposes for one year, for contributions made in taxable years beginning before January 1, 2015.

Effective Date

The provision is effective for contributions made in taxable years beginning after December 31, 2013.

[83] IRC section 170(b)(2)(B).

[84] IRC sections 170(b)(1)(E)(vi) and 170(b)(2)(B)(iii).

California Law (R&TC sections 17201, 17275.5, and 24357-24357.9)

The Personal Income Tax Law conforms to the federal rules for charitable contributions as of the "specified date" of January 1, 2009, with modifications.[85] Thus, the Personal Income Tax Law generally conforms to the federal rules for general charitable contributions and the rules for contributions of capital gain property, but does not conform to the federal special rule regarding contributions of capital gain real property for conservation purposes. As a result, qualified conservation contributions of capital gain real property under the Personal Income Tax Law are subject to the same limitations and carryover rules as other charitable contributions of capital gain property.

Under the Corporation Tax Law, California has stand-alone law for corporate charitable contribution deductions that incorporates some of the federal contribution rules by reference.[86] In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10 percent of the corporation's taxable income computed without regard to net operating or capital loss carrybacks, and any excess may be carried forward for up to five years.[87] The Corporation Tax Law provides its own rules for qualified conservation contributions that generally parallel the federal rules for such contributions;[88] for example, such contributions are not subject to the "partial interest" rule. However, the Corporation Tax Law does not conform to the federal special rule regarding contributions of capital gain real property (by certain corporate farmers and ranchers) for conservation purposes; instead, the amount of charitable contribution deduction for such contributed property is specifically limited to the adjusted basis of that property.[89]

Impact on California Revenue

None (the federal provision expired for contributions made on or after January 1, 2015).

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[85] R&TC section 17201 conforms to IRC section 170, relating to charitable contributions, as of the "specified date" of January 1, 2009, with modifications in R&TC section 17275.5.

[86] R&TC sections 24357-24357.9.

[87] R&TC section 24357.

[88] R&TC sections 24357.2 and 24357.7.

[89] R&TC section 24357.1.

Section	Section Title
107	Extension of Above-the-Line Deduction for Qualified Tuition and Related Expenses

Background

An individual is allowed a deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[90] The deduction is allowed in computing adjusted gross income. The term "qualified tuition and related expenses" is defined in the same manner as for the Hope and Lifetime Learning credits, and includes tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution.[91] The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic period beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

The maximum deduction is $4,000 for an individual whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 in the case of a joint return). No deduction is allowed for an individual whose adjusted gross income exceeds the relevant adjusted gross income limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2013.

The amount of qualified tuition and related expenses must be reduced by certain scholarships, educational assistance allowances, and other amounts paid for the benefit of such individual,[92] and by the amount of such expenses taken into account for purposes of determining any exclusion from gross income of: (1) income from certain U.S. savings bonds used to pay higher education tuition and fees; and (2) income from a Coverdell education savings account.[93] Additionally, such expenses must be reduced by the earnings portion (but not the return of principal) of distributions from a qualified tuition program if an exclusion from income under IRC section 529 is claimed with respect to expenses eligible for the qualified tuition deduction. No deduction is allowed for any expense for which a deduction is otherwise allowed or with respect to an individual for whom a Hope or Lifetime Learning credit is elected for such taxable year.

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[90] IRC section 222.

[91] The deduction generally is not available for expenses with respect to a course or education involving sports, games, or hobbies, and is not available for student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

[92] IRC sections 222(d)(1) and 25A(g)(2).

[93] IRC section 222(c). These reductions are the same as those that apply to the Hope and Lifetime Learning credits.

New Federal Law (IRC section 222)

The provision extends the qualified tuition deduction for one year, through 2014.

Effective Date

The provision is effective for taxable years beginning after December 31, 2013.

California Law (R&TC section 17204.7)

California specifically does not conform to the federal qualified tuition deduction. As a result, California does not allow a deduction for qualified tuition and related expenses, and taxpayers who deduct such expenses on their federal tax returns report the amount deducted for federal purposes as a California adjustment on Schedule CA (540/540NR).

Impact on California Revenue

Not applicable.

Section	Section Title
108	Extension of Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes

Background

In General

If an amount withdrawn from a traditional individual retirement arrangement (IRA) or a Roth IRA is donated to a charitable organization, the rules relating to the tax treatment of withdrawals from IRAs apply to the amount withdrawn and the charitable contribution is subject to the normally applicable limitations on the deductibility of such contributions. An exception applies in the case of a qualified charitable distribution.

Charitable Contributions

In computing taxable income, an individual taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and up to the fair market value of property contributed to the following entities: (1) a charity described in IRC section 170(c)(2); (2) certain veterans' organizations, fraternal societies, and cemetery companies;[94] and (3) a federal, state, or local

[94] IRC sections 170(c)(3)-(5).

governmental entity, but only if the contribution is made for exclusively public purposes.[95] The deduction also is allowed for purposes of calculating alternative minimum taxable income.

The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.[96]

A taxpayer who takes the standard deduction (i.e., who does not itemize deductions) may not take a separate deduction for charitable contributions.[97]

A payment to a charity (regardless of whether it is termed a ‘‘contribution’’) in exchange for which the donor receives an economic benefit is not deductible, except to the extent that the donor can demonstrate, among other things, that the payment exceeds the fair market value of the benefit received from the charity. To facilitate distinguishing charitable contributions from purchases of goods or services from charities, present law provides that no charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service provided) to the taxpayer in consideration for the contribution.[98] In addition, present law requires that any charity that receives a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a ‘‘quid-pro-quo’’ contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services may be deductible as a charitable contribution.[99]

Under present law, total deductible contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private non-operating foundations generally may not exceed 50 percent of the taxpayer’s contribution base, which is the taxpayer’s adjusted gross income for a taxable year (disregarding any net operating loss carryback). To the extent a taxpayer has not exceeded the 50-percent limitation, (1) contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer’s contribution base, (2) contributions of cash to most private non-operating foundations and certain other charitable organizations generally may be deducted up to 30 percent of the taxpayer’s contribution base, and (3) contributions of capital gain property to private foundations and certain other charitable organizations generally may be deducted up to 20 percent of the taxpayer’s contribution base.

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[95] IRC section 170(c)(1).

[96] IRC sections 170(b) and (e).

[97] IRC section 170(a).

[98] IRC section 170(f)(8). For any contribution of cash, check, or other monetary gift, no deduction is allowed unless the donor maintains as a record of such contribution a bank record or written communication from the donee charity showing the name of the donee organization, the date of the contribution, and the amount of the contribution. IRC section 170(f)(17).

[99] IRC section 6115.

Contributions by individuals in excess of the 50-percent, 30-percent, and 20-percent limits generally may be carried over and deducted over the next five taxable years, subject to the relevant percentage limitations on the deduction in each of those years.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a non-charity for less than full and adequate consideration.[100] Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, pooled income funds, and present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property.[101] For such interests, a charitable deduction is allowed to the extent of the present value of the interest designated for a charitable organization.

IRA Rules

Within limits, individuals may make deductible and nondeductible contributions to a traditional IRA. Amounts in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of nondeductible contributions). Certain individuals also may make nondeductible contributions to a Roth IRA (deductible contributions cannot be made to Roth IRAs). Qualified withdrawals from a Roth IRA are excludable from gross income. Withdrawals from a Roth IRA that are not qualified withdrawals are includible in gross income to the extent attributable to earnings. Includible amounts withdrawn from a traditional IRA or a Roth IRA before attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies. Under present law, minimum distributions are required to be made from tax-favored retirement arrangements, including IRAs. Minimum required distributions from a traditional IRA must generally begin by April 1 of the calendar year following the year in which the IRA owner attains age 70½.[102]

If an individual has made nondeductible contributions to a traditional IRA, a portion of each distribution from an IRA is nontaxable until the total amount of nondeductible contributions has been received. In general, the amount of a distribution that is nontaxable is determined by multiplying the amount of the distribution by the ratio of the remaining nondeductible contributions to the account balance. In making the calculation, all traditional IRAs of an individual are treated as a single IRA, all distributions during any taxable year are treated as a single distribution, and the value of the contract, income on the contract, and investment in the contract are computed as of the close of the calendar year.

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[100] IRC sections 170(f), 2055(e)(2), and 2522(c)(2).

[101] IRC section 170(f)(2).

[102] Minimum distribution rules also apply in the case of distributions after the death of a traditional or Roth IRA owner.

In the case of a distribution from a Roth IRA that is not a qualified distribution, in determining the portion of the distribution attributable to earnings, contributions, and distributions are deemed to be distributed in the following order: (1) regular Roth IRA contributions; (2) taxable conversion contributions;[103] (3) nontaxable conversion contributions; and (4) earnings. In determining the amount of taxable distributions from a Roth IRA, all Roth IRA distributions in the same taxable year are treated as a single distribution, all regular Roth IRA contributions for a year are treated as a single contribution, and all conversion contributions during the year are treated as a single contribution.

Distributions from an IRA (other than a Roth IRA) are generally subject to withholding unless the individual elects not to have withholding apply.[104] Elections not to have withholding apply are to be made in the time and manner prescribed by the Secretary of the Treasury.

Qualified Charitable Distributions

Under a temporary provision applicable for taxable years beginning before January 1, 2014, otherwise taxable IRA distributions from a traditional or Roth IRA are excluded from gross income to the extent they are qualified charitable distributions.[105] The exclusion may not exceed $100,000 per taxpayer per taxable year. Special rules apply in determining the amount of an IRA distribution that is otherwise taxable. The otherwise applicable rules regarding taxation of IRA distributions and the deduction of charitable contributions continue to apply to distributions from an IRA that are not qualified charitable distributions. A qualified charitable distribution is taken into account for purposes of the minimum distribution rules applicable to traditional IRAs to the same extent the distribution would have been taken into account under such rules had the distribution not been directly distributed under the qualified charitable distribution provision. An IRA does not fail to qualify as an IRA as a result of qualified charitable distributions being made from the IRA.

A qualified charitable distribution is any distribution from an IRA directly by the IRA trustee to an organization described in IRC section 170(b)(1)(A) (other than an organization described in IRC section 509(a)(3) or a donor advised fund (as defined in IRC section 4966(d)(2)). Distributions are eligible for the exclusion only if made on or after the date the IRA owner attains age 70½ and only to the extent the distribution would be includible in gross income (without regard to this provision).

The exclusion applies only if a charitable contribution deduction for the entire distribution otherwise would be allowable (under present law), determined without regard to the generally applicable percentage limitations. Thus, for example, if the deductible amount is reduced because of a benefit received in exchange, or if a deduction is not allowable because the donor

[103] Conversion contributions refer to conversions of amounts in a traditional IRA to a Roth IRA.

[104] IRC section 3405.

[105] IRC section 408(d)(8). The exclusion does not apply to distributions from employer-sponsored retirement plans, including SIMPLE IRAs and simplified employee pensions (SEPs).

did not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.

If the IRA owner has any IRA that includes nondeductible contributions, a special rule applies in determining the portion of a distribution that is includible in gross income (but for the qualified charitable distribution provision) and thus is eligible for qualified charitable distribution treatment. Under the special rule, the distribution is treated as consisting of income first, up to the aggregate amount that would be includible in gross income (but for the qualified charitable distribution provision) if the aggregate balance of all IRAs having the same owner were distributed during the same year. In determining the amount of subsequent IRA distributions includible in income, proper adjustments are to be made to reflect the amount treated as a qualified charitable distribution under the special rule.

Distributions that are excluded from gross income by reason of the qualified charitable distribution provision are not taken into account in determining the deduction for charitable contributions under IRC section 170.

Under present law, the exclusion does not apply to distributions made in taxable years beginning after December 31, 2013.

New Federal Law (IRC section 408)

The provision extends the exclusion for qualified charitable distributions for one year, to distributions made in taxable years beginning before January 1, 2015.

Effective Date

The provision is effective for contributions made in taxable years beginning after December 31, 2013.

California Law (R&TC section 17501)

In general, California automatically conforms to the federal pension rules,[106] including this provision's extension of the automatic extension of amortization periods.

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[106] R&TC section 17501 conforms by reference to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC sections 17501(b) and 17551(c) specifically provide that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC, and IRC section 457, automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Impact on California Revenue

Baseline.

Section	Section Title
111	Extension of Research Credit

Background

General Rule

For general research expenditures, a taxpayer may claim a research credit equal to 20 percent of the amount by which the taxpayer's qualified research expenses for a taxable year exceed its base amount for that year.[107] Thus, the research credit generally is available with respect to incremental increases in qualified research. An alternative simplified research credit (with a 14 percent rate and a different base amount) may be claimed in lieu of this credit.[108]

University Basic Research Credit

A 20-percent research credit is also available with respect to the excess of: (1) 100 percent of corporate cash expenses (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations), over (2) the sum of (a) the greater of two minimum basic research floors, plus (b) an amount reflecting any decrease in non-research giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the university basic research credit.[109]

Energy Research Credit

A research credit is available for a taxpayer's expenditures on research undertaken by an energy research consortium. This separate credit computation is commonly referred to as the energy research credit. Unlike the other research credits, the energy research credit applies to all qualified expenditures, not just those in excess of a base amount.

[107] IRC section 41.

[108] The alternative simplified research credit is equal to 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to 6 percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years. An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary of the Treasury.

[109] IRC section 41(e).

Credit Expiration

The research credit, including the university basic research credit and the energy research credit, is not available for amounts paid or incurred after December 31, 2013.[110]

Computation of Allowable Credit

Except for energy research payments and certain university basic research payments made by corporations, the research credit applies only to the extent that the taxpayer's qualified research expenses for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenses and had gross receipts during each of at least three years from 1984 through 1988, then its fixed-base percentage is the ratio that its total qualified research expenses for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum fixed-base percentage of 16 percent). Special rules apply to all other taxpayers (so called start-up firms).[111] In computing the credit, a taxpayer's base amount cannot be less than 50 percent of its current-year qualified research expenses.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations or all members of a group of businesses under common control are treated as a single taxpayer.[112] The credit allowable to each member is its proportionate share of the qualified research expenses, basic research payments, and energy research payments giving rise to the credit.

Under regulations prescribed by the Secretary of the Treasury, special rules apply for computing the research credit when a major portion of a trade or business (or unit thereof) changes hands. Under these rules, qualified research expenses and gross receipts arising in taxable years prior to the change of ownership of a trade or business are treated as transferred to the acquiring taxpayer with the trade or business that gave rise to those expenses and receipts for purposes of

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[110] IRC section 41(h), as amended by Section 301 of the American Taxpayer Relief Act of 2012 (Public Law 112-240).

[111] The Small Business Job Protection Act of 1996 expanded the definition of start-up firms under IRC section 41(c)(3)(B)(i) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983. A special rule (enacted in 1993) is designed to gradually re-compute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm is assigned a fixed-base percentage of three percent for each of its first five taxable years after 1993 in which it incurs qualified research expenses. A start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenses is a phased-in ratio based on the firm's actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage is its actual ratio of qualified research expenses to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993. IRC section 41(c)(3)(B).

[112] IRC section 41(f)(1).

re-computing the acquiring taxpayer's fixed-base percentage.[113] Qualified research expenses incurred during the taxable year including or ending with a change of ownership are treated as transferred to the acquiring taxpayer with the trade or business for purposes of determining the credit for the acquiring taxpayer's first taxable year including the acquisition.

Alternative Incremental Credit

For taxable years beginning before January 1, 2009, taxpayers were allowed to elect an alternative incremental research credit regime.[114] A taxpayer electing to be subject to this alternative regime was assigned a three-tiered fixed-base percentage (that was lower than the fixed-base percentage otherwise applicable) and the credit rate likewise was reduced.

Generally, for amounts paid or incurred prior to 2007, under the alternative incremental credit regime, a credit rate of 2.65 percent applied to the extent that a taxpayer's current-year research expenses exceeded a base amount computed by using a fixed-base percentage of one percent (i.e., the base amount equaled one percent of the taxpayer's average gross receipts for the four preceding years) but did not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 3.2 percent applied to the extent that a taxpayer's current-year research expenses exceeded a base amount computed by using a fixed-base percentage of 1.5 percent but did not exceed a base amount computed by using a fixed-base percentage of 2 percent. A credit rate of 3.75 percent applied to the extent that a taxpayer's current-year research expenses exceeded a base amount computed by using a fixed-base percentage of 2 percent. Generally, for amounts paid or incurred after 2006, the credit rates listed above were increased to three percent, four percent, and five percent, respectively.[115]

Alternative Simplified Credit

The alternative simplified research credit is equal to 14 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. The rate is reduced to six percent if a taxpayer has no qualified research expenses in any one of the three preceding taxable years. An election to use the alternative simplified credit applies to all succeeding taxable years unless revoked with the consent of the Secretary of the Treasury.

Eligible Expenses

Qualified research expenses eligible for the research tax credit consist of: (1) in-house expenses of the taxpayer for wages and supplies attributable to qualified research, (2) certain time-sharing costs for computer use in qualified research, and (3) 65 percent of amounts paid or incurred by the taxpayer to certain other persons for qualified research conducted on the taxpayer's behalf

[113] IRC section 41(f)(3).

[114] IRC section 41(c)(4).

[115] A special transition rule applied for fiscal year 2006-2007 taxpayers.

(so-called contract research expenses).[116] Notwithstanding the limitation for contract research expenses, qualified research expenses include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or federal laboratory for qualified energy research.

To be eligible for the credit, the research not only has to satisfy the requirements of present-law IRC section 174 (described below) but also must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and substantially all of the activities of which constitute elements of a process of experimentation for functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, or cosmetic or seasonal design factors.[117] In addition, research does not qualify for the credit if (1) conducted after the beginning of commercial production of the business component, (2) related to the adaptation of an existing business component to a particular customer's requirements, (3) related to the duplication of an existing business component from a physical examination of the component itself or certain other information, (4) related to certain efficiency surveys, management function or technique, market research, market testing, or market development, routine data collection or routine quality control, (5) related to software developed primarily for internal use by the taxpayer, (6) related to social sciences, arts, or humanities, or (7) funded by any grant, contract, or otherwise by another person (or governmental entity).[118] Research does not qualify for the credit if it is conducted outside the United States, Puerto Rico, or any U.S. possession.

Relation to Deduction

Under IRC section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures paid or incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized.[119] However, deductions allowed to a taxpayer under IRC section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.[120]

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[116] Under a special rule, 75 percent of amounts paid to a research consortium for qualified research are treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under IRC section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in IRC section 501(c)(3) (other than a private foundation) or IRC section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer. IRC section 41(b)(3)(C).

[117] IRC section 41(d)(3).

[118] IRC section 41(d)(4).

[119] Taxpayers may elect 10-year amortization of certain research expenditures allowable as a deduction under IRC section 174(a). IRC sections 174(f)(2) and 59(e).

[120] IRC section 280C(c).

Taxpayers may alternatively elect to claim a reduced research tax credit amount under IRC section 41 in lieu of reducing deductions otherwise allowed.[121]

New Federal Law (IRC sections 41 and 45C)

The provision extends the research credit for one year, through 2014.

Effective Date

The provision is effective for amounts paid or incurred after December 31, 2013.

California Law (R&TC sections 17052.12 and 23609)

In General

The Personal Income Tax Law and the Corporation Tax Law generally conform to the federal research credit as of the “specified date” of January 1, 2009, with modifications, as generally described below.

Credit Percentages

California modifies the general credit to be 15 percent of qualified expenses (instead of the federal rate of 20 percent of qualified expenses) and modifies the university “basic research” credit to be 24 percent of qualified expenses (instead of the federal rate of 20 percent of qualified expenses).

California Requirements

The terms “qualified research” and “basic research” include only research conducted in California. In computing gross receipts under IRC section 41(c)(7), only gross receipts from the sale of property held for sale in the ordinary course of business, that is delivered or shipped to a purchaser within California, are included. Qualified research expenses are modified to exclude any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax under R&TC section 6378.

[121] IRC section 280C(c)(3).

University "Basic Research" Credit

Similar to federal law, only corporations qualify for the credit for the university "basic research" credit. However, California modifies "basic research" to include any basic or applied research including scientific inquiry or original investigation for advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except the term does not include any of the following:

1. Basic research conducted outside California;
2. Basic research in social sciences, arts or humanities;
3. Basic research for purposes of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors; or,
4. Any expenditure paid or incurred to ascertain existence, location, extent, or quality of any deposit of ore or other mineral, including oil or gas.

Energy Research Credit

California does not conform to the energy research credit.[122]

Alternative Incremental Credit

California conforms to the alternative incremental credit, with modifications.

For California purposes, the federal credit rates of 3 percent, 4 percent and 5 percent are modified to be 1.49 percent, 1.98 percent, and 2.48 percent, respectively.[123]

Additionally, the federal December 31, 2008, election-termination date does not apply,[124] meaning taxpayers may continue to elect the alternative incremental credit regime under California law even though such an election may not be made for federal purposes in taxable years beginning after December 31, 2008.

Alternative Simplified Credit

California specifically does not conform to the alternative simplified credit.[125]

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[122] R&TC sections 17052.12(j) and 23609(k).

[123] R&TC sections 17052.12(g) and 23609(h).

[124] R&TC sections 17052.12(h) and 23609(i).

[125] R&TC sections 17052.12(g)(4) and 23609(g)(4).

Eligible Expenses

California generally conforms to the federal rules for eligible expenses, but does not conform to the special rules that allow qualified research expenses to include 100 percent of amounts paid or incurred by the taxpayer to an eligible small business, university, or federal laboratory for qualified energy research.

Extension

The Personal Income Tax Law and the Corporation Tax Law specifically do not conform to the federal credit termination date,[126] which means the research credit is permanent under California law, and this provision's one-year extension does not apply.

Impact on California Revenue

Not applicable.

Section	Section Title
112	Extension of Temporary Minimum Low-Income Housing Tax Credit Rate for Non-Federally Subsidized Buildings

Background

In General

The low-income housing credit may be claimed over a 10-year credit period after each low-income building is placed in service. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building.

Present Value Credit

The calculation of the applicable percentage is designed to produce a credit equal to:
(1) 70 percent of the present value of the building's qualified basis in the case of newly constructed or substantially rehabilitated housing that is not federally subsidized (the "70-percent credit"), or (2) 30 percent of the present value of the building's qualified basis in the case of newly-constructed or substantially-rehabilitated housing that is federally subsidized and existing housing that is substantially rehabilitated (the "30-percent credit"). Where existing housing is substantially rehabilitated, the existing housing is eligible for the 30-percent credit and the qualified rehabilitation expenses (if not federally subsidized) are eligible for the 70-percent credit.

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[126] R&TC sections 17052.12(h) and 23609(i).

Calculation of the Applicable Percentage

In General

The credit percentage for a low-income building is set for the earlier of (1) the month the building is placed in service, or (2) at the election of the taxpayer, (a) the month the taxpayer and the housing credit agency enter into a binding agreement with respect to such building for a credit allocation, or (b) in the case of a tax-exempt bond-financed project for which no credit allocation is required, the month in which the tax-exempt bonds are issued.

These credit percentages (used for the 70-percent credit and 30-percent credit) are adjusted monthly by the IRS on a discounted after-tax basis (assuming a 28-percent tax rate) based on the average of the applicable federal rates for mid-term and long-term obligations for the month the building is placed in service. The discounting formula assumes that each credit is received on the last day of each year and that the present value is computed on the last day of the first year. In a project consisting of two or more buildings placed in service in different months, a separate credit percentage may apply to each building.

Special Rule

Under a special rule, the applicable percentage is set at a minimum of 9 percent for newly-constructed non-federally subsidized buildings placed in service after July 30, 2008, and before December 31, 2014.

<u>New Federal Law (IRC section 42)</u>

The provision extends the temporary minimum applicable percentage of 9 percent for newly-constructed non-federally subsidized buildings with respect to which credit allocations are made before January 1, 2015.

<u>Effective Date</u>

The provision is effective on January 1, 2014.

<u>California Law (R&TC sections 17057.5, 17058, 23610.4, and 23610.5)</u>

In General

The Personal Income Tax Law and the Corporation Tax Law conform to IRC section 42, relating to the low-income housing credit, as of the "specified date" of January 1, 2009,[127] modified to provide that the applicable percentage for newly-constructed non-federally subsidized buildings for the first three years is the percentage prescribed by the Secretary of the Treasury for the taxable year, and for the fourth year, the percentage is the difference between 30 percent and the

[127] R&TC sections 17058 and 23610.5 conform to IRC section 42 as of the "specified date" of January 1, 2009, with modifications.

sum of the credit percentages for the first three years.[128] Additional California modifications are discussed below.

California Housing

In order to qualify for the California low-income housing credit, the low-income housing project must be located in California.

California Tax Credit Allocation Committee

The California Tax Credit Allocation Committee is required to allocate this credit based on the project's need for economic feasibility. Thus, the amount of the California tax credit allocated to a project cannot exceed the amount that, in addition to the federal credit allocated to that project, is necessary for the financial feasibility of the project and its viability throughout the extended-use period.

Credit Amount and Credit Period

Generally, the percentage of costs for which the credit may be taken in the first three years is the highest percentage allowed under federal law in the month the building is placed in service. For the fourth year, the percentage is the difference between 30 percent and the sum of the credit percentage for the first three years.

For new buildings that are federally subsidized and existing buildings that are at risk of conversion to market rental rates, the percentage of creditable costs in the first three years is the same as the federal percentage applicable to the subsidized new buildings. For the fourth year, the percentage is the difference between 13 percent and the sum of the credit percentages for the first three years.

Compliance Period

California uses a 30-year compliance period instead of the federal 15-year period.

Basis Adjustments

California modifies the federal rule for the increase in qualified basis after the first year of the credit period.[129] When the basis of a building that has been granted a low-income housing tax credit is increased and exceeds the basis at the end of the first year of the four-year credit period, the taxpayer is eligible for a credit on the excess basis. This additional credit is also taken over a four-year period beginning with the taxable year in which the increase in qualified basis occurs.

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[128] R&TC sections 17058(c)(2) and 23610.5(c)(2).

[129] IRC section 42(f)(3).

Partnership Allocations

For partnership allocations of low-income housing credits occurring on or after January 1, 2009, and before January 1, 2016, the credit must be allocated to the partners of a partnership owning the project based on the partnership agreement, regardless how the federal credit is allocated and regardless of whether the allocation of the credit under the partnership agreement has "substantial economic effect" within the meaning of IRC section 704(b). To the extent the allocation of the credit to a partner lacks substantial economic effect, any loss or deduction attributable to the sale, transfer, exchange, abandonment, or any other disposition of a partnership interest prior to the federal credit's expiration is deferred and treated as if it occurred in the first taxable year immediately following the taxable year in which the federal credit period expires.[130]

Impact on California Revenue

None—although California law does not conform to this provision's changes that extend the temporary minimum applicable percentage of 9 percent for newly-constructed non-federally subsidized buildings with respect to which credit allocations are made before January 1, 2015, there is no net revenue impact because the California Tax Credit Allocation Committee currently allocates the entire amount of state credit available.

Section	Section Title
113	Extension of Military Housing Allowance Exclusion for Determining Whether a Tenant in Certain Counties is Low Income

Background

In General

In order to be eligible for the low-income housing credit, a qualified low-income building must be part of a qualified low-income housing project. In general, a qualified low-income housing project is defined as a project that satisfies one of two tests at the election of the taxpayer. The first test is met if 20 percent or more of the residential units in the project are both rent-restricted, and occupied by individuals whose income is 50 percent or less of area median gross income (the "20–50 test"). The second test is met if 40 percent or more of the residential units in such project are both rent-restricted, and occupied by individuals whose income is 60 percent or less of area median gross income (the "40–60 test"). These income figures are adjusted for family size.

[130] R&TC sections 17058(b)(1)(C) and 23610.5(b)(1)(C).

Rule for Income Determinations – On or Before July 30, 2008, and On or After January 1, 2014

The recipients of the military basic housing allowance must include these amounts for purposes of low-income credit eligibility income test, as described above.

Special Rule for Income Determinations - Before January 1, 2014

Under the provision the basic housing allowance (i.e., payments under 37 U.S.C. sec. 403) is not included in income for the low-income credit income eligibility rules. The provision is limited in application to qualified buildings. A qualified building is defined as any building located in:

1. Any county which contains a qualified military installation to which the number of members of the Armed Forces assigned to units based out of such qualified military installation has increased by 20 percent or more as of June 1, 2008, over the personnel level on December 31, 2005; and
2. Any counties adjacent to a county described in (1), above. For these purposes, a qualified military installation is any military installation or facility with at least 1,000 members of the Armed Forces assigned to it.

The provision applies to income determinations (1) made after July 30, 2008, and before January 1, 2014, in the case of qualified buildings which received credit allocations on or before July 30, 2008, or qualified buildings placed in service on or before July 30, 2008, to the extent a credit allocation was not required with respect to such building by reason of IRC section 42(h)(4) (i.e. such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued before July 30, 2008, and (2) made after July 30, 2008, in the case of qualified buildings which received credit allocations after July 30, 2008, and before January 1, 2014, or qualified buildings placed in service after July 30, 2008, and before January 1, 2014, to the extent a credit allocation was not required with respect to such qualified building by reason of IRC section 42(h)(4) (i.e. such qualified building was at least 50 percent tax-exempt bond financed with bonds subject to the private activity bond volume cap) but only with respect to bonds issued after July 30, 2008, and before January 1, 2014.

New Federal Law (IRC section 142)

The provision extends the special rule for one additional year (through December 31, 2014).

Effective Date

The provision is effective as if included in the enactment of Section 3005 of the Housing Assistance Tax Act of 2008.[131]

[131] Public Law 110-289.

California Law (R&TC sections 17057.5, 17058, 17143, 23610.4, and 23610.5)

Exempt Facility Bonds

California does not conform to, or adopt, IRC section 142, relating to exempt facility bonds.[132]

California Low-Income Housing Credit – General Conformity to Federal Law

The Personal Income Tax Law and the Corporation Tax Law conform to IRC section 42, relating to the low-income housing credit, as of the "specified date" of January 1, 2009, with modifications.[133]

California law does not conform to this provision's changes to the extent that they modify the applicable low-income eligibility rules for purposes of determining qualified buildings. However, there is no net change to the total amount of California low-income housing credits because the California Tax Credit Allocation Committee currently allocates the entire amount of state credit available.

California Low-Income Housing Credit – In General

In order to qualify for the California low-income housing credit, the low-income housing project must be located in California. Additional California modifications to the federal credit are discussed below.

California Tax Credit Allocation Committee

The California Tax Credit Allocation Committee is required to allocate this credit based on the project's need for economic feasibility. Thus, the amount of the California tax credit allocated to a project cannot exceed the amount that, in addition to the federal credit allocated to that project, is necessary for the financial feasibility of the project and its viability throughout the extended use period.

Credit Amount and Credit Period

Generally, the percentage of costs for which the credit may be taken in the first three years is the highest percentage allowed under federal law in the month the building is placed in service. For the fourth year, the percentage is the difference between 30 percent and the sum of the credit percentage for the first three years.

For new buildings that are federally subsidized and existing buildings that are at risk of conversion to market rental rates, the percentage of creditable costs in the first three years is the same as

[132] R&TC section 17143.

[133] R&TC sections 17058 and 23610.5 conform to IRC section 42 as of the "specified date" of January 1, 2009, with modifications.

the federal percentage applicable to the subsidized new buildings. For the fourth year, the percentage is the difference between 13 percent and the sum of the credit percentages for the first three years.

Compliance Period

California uses a 30-year compliance period instead of the federal 15-year period.

Basis Adjustments

California modifies the federal rule for the increase in qualified basis after the first year of the credit period.[134] When the basis of a building that has been granted a low-income housing tax credit is increased and exceeds the basis at the end of the first year of the four-year credit period, the taxpayer is eligible for a credit on the excess basis. This additional credit is also taken over a four-year period beginning with the taxable year in which the increase in qualified basis occurs.

Partnership Allocations

For partnership allocations of low-income housing credits occurring on or after January 1, 2009, and before January 1, 2016, the credit must be allocated to the partners of a partnership owning the project based on the partnership agreement, regardless of how the federal credit is allocated and regardless of whether the allocation of the credit under the partnership agreement has "substantial economic effect" within the meaning of IRC section 704(b). To the extent the allocation of the credit to a partner lacks substantial economic effect, any loss or deduction attributable to the sale, transfer, exchange, abandonment, or any other disposition of a partnership interest prior to the federal credit's expiration is deferred and treated as if it occurred in the first taxable year immediately following the taxable year in which the federal credit period expires.[135]

Impact on California Revenue

None—to the extent that California would conform to this provision's extension of the special rule for income determinations (i.e., the exclusion of the basic housing allowance for purposes of determining qualified buildings), there would be no net revenue impact because the California Tax Credit Allocation Committee currently allocates the entire amount of state credit available.

[134] IRC section 42(f)(3).

[135] R&TC sections 17058(b)(1)(C) and 23610.5(b)(1)(C).

Section	Section Title
114	Extension of Indian Employment Tax Credit

Background

In general, a credit against income tax liability is allowed to employers for the first $20,000 of qualified wages and qualified employee health insurance costs paid or incurred by the employer with respect to certain employees.[136] The credit is equal to 20 percent of the excess of eligible employee qualified wages and health insurance costs during the current year over the amount of such wages and costs incurred by the employer during 1993. The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993. No deduction is allowed for the portion of the wages equal to the amount of the credit.

Qualified wages means wages paid or incurred by an employer for services performed by a qualified employee. A qualified employee means any employee who is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe, who performs substantially all of the services within an Indian reservation, and whose principal place of abode while performing such services is on or near the reservation in which the services are performed.

An "Indian reservation" is a reservation as defined in section 3(d) of the Indian Financing Act of 1974[137] or section 4(10) of the Indian Child Welfare Act of 1978.[138] For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

An employee is not treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during the taxable year exceeds an amount determined at an annual rate of $30,000 (which after adjusted for inflation is $45,000 for 2011). In addition, an employee will not be treated as a qualified employee under certain specific circumstances, such as where the employee is related to the employer (in the case of an individual employer) or to one of the employer's shareholders, partners, or grantors. Similarly, an employee will not be treated as a qualified employee where the employee has more than a five-percent ownership interest in the employer. Finally, an employee will not be considered a qualified employee to the extent the employee's services relate to gaming activities or are performed in a building housing such activities.

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[136] IRC section 45A.

[137] Public Law 93–262.

[138] Public Law 95–608.

The wage credit is available for wages paid or incurred in taxable years that begin before January 1, 2014.

New Federal Law (IRC section 45A)

The provision extends for one year the present-law employment credit provision (through taxable years beginning on or before December 31, 2015).

Effective Date

The provision is effective for taxable years beginning after December 31, 2013.

California Law (None)

California does not conform to the Indian Employment Tax Credit.

Impact on California Revenue

Not applicable.

Section	Section Title
115	Extension of New Markets Tax Credit

Background

IRC section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity (CDE).[139] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is: (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years.[140] The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.[141] The credit is recaptured if at any time during the seven-year period that begins on the

[139] IRC section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Public Law 106-554 (December 21, 2000).

[140] IRC section 45D(a)(2).

[141] IRC section 45D(a)(3).

date of the original issue of the investment the entity: (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.[142]

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons, (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE, and (3) that is certified by the Secretary of the Treasury as being a qualified CDE.[143] A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired directly from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder.[144] Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community businesses, (2) certain financial counseling and other services to businesses and residents in low-income communities, (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment, or (4) an equity investment in, or loan to, another CDE.[145]

A "low-income community" is a population census tract with either a poverty rate of at least 20 percent or median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.[146] For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary of the Treasury is authorized to designate "targeted populations" as low-income communities for purposes of the new markets tax credit.[147] For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994[148] (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate

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[142] IRC section 45D(g).

[143] IRC section 45D(c).

[144] IRC section 45D(b).

[145] IRC section 45D(d).

[146] IRC section 45D(e).

[147] IRC section 45D(e)(2).

[148] Public Law 103-325.

access to loans or equity investments. Section 103(17) of the Act provides that "low-income" means: (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income, and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income, or 80 percent of the statewide non-metropolitan area median family income.[149] A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under IRC section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community, (2) a substantial portion of the tangible property of the business is used in a low-income community, (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community, and (4) less than five percent of the average of the aggregate unadjusted bases of the property of the business is attributable to certain financial property or to certain collectibles.[150]

The maximum annual amount of qualified equity investments was $3.5 billion for calendar years 2010 through 2013. The new markets tax credit expired on December 31, 2013.

<u>New Federal Law (IRC section 45D)</u>

The provision extends the new markets tax credit for one year, through 2014, permitting up to $3.5 billion in qualified equity investments for the 2014 calendar year. The provision also extends for one year, through 2019, the carryover period for unused new markets tax credits.

<u>Effective Date</u>

The provision applies to calendar years beginning after December 31, 2013.

<u>California Law (R&TC sections 17053.57 and 23657)</u>

New Markets Tax Credit

California does not conform to the federal new markets tax credit.

<u>Impact on California Revenue</u>

Not applicable.

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[149] Public Law 103-325.

[150] IRC section 45D(d)(2).

Section	Section Title
116	Extension of Railroad Track Maintenance Credit

Background

Present law provides a 50-percent business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during taxable years beginning before January 1, 2014.[151] The credit is limited to the product of $3,500 times the number of miles of railroad track owned or leased by an eligible taxpayer as of the close of its taxable year, and assigned to the eligible taxpayer by a Class II or Class III railroad that owns or leases such track at the close of the taxable year.[152] Each mile of railroad track may be taken into account only once, either by the owner of such mile or by the owner's assignee, in computing the per-mile limitation. The credit may also reduce a taxpayer's tax liability below its tentative minimum tax.[153]

Qualified railroad track maintenance expenditures are defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad (determined without regard to any consideration for such expenditure given by the Class II or Class III railroad which made the assignment of such track).[154]

An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad or who furnishes railroad-related property or services to a Class II or Class III railroad, but only with respect to miles of railroad track assigned to such person by such railroad under the provision.[155]

The terms Class II or Class III railroad have the meanings given by the Surface Transportation Board.[156]

New Federal Law (IRC section 45G)

The provision extends the present law credit for one year, for qualified railroad track maintenance expenses paid or incurred during taxable years beginning after December 31, 2013, and before January 1, 2015.

151 IRC section 45G(a).

152 IRC section 45G(b)(1).

153 IRC section 38(c)(4).

154 IRC section 45G(d).

155 IRC section 45G(c).

156 IRC section 45G(e)(1).

Effective Date

The provision is effective for expenses paid or incurred in taxable years beginning after December 31, 2013.

California Law (None)

California does not conform to the railroad track maintenance credit.

Impact on California Revenue

Not applicable.

Section	Section Title
117	Extension of Mine Rescue Team Training Credit

Background

An eligible employer may claim a general business credit against income tax with respect to each qualified mine rescue team employee equal to the lesser of: (1) 20 percent of the amount paid or incurred by the taxpayer during the taxable year with respect to the training program costs of the qualified mine rescue team employee (including the wages of the employee while attending the program), or (2) $10,000. A qualified mine rescue team employee is any full-time employee of the taxpayer who is a miner eligible for more than six months of a taxable year to serve as a mine rescue team member by virtue of either having completed the initial 20 hour course of instruction prescribed by the Mine Safety and Health Administration's Office of Educational Policy and Development, or receiving at least 40 hours of refresher training in such instruction.
An eligible employer is any taxpayer that employs individuals as miners in underground mines in the United States. The term “wages” has the meaning given to such term by IRC section 3306(b)[157] (determined without regard to any dollar limitation contained in that section).

No deduction is allowed for the portion of the expenses otherwise deductible that is equal to the amount of the credit,[158] and the credit may not offset the alternative minimum tax.[159]

The credit does not apply to taxable years beginning after December 31, 2013.

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[157] IRC section 3306(b) defines wages for purposes of Federal Unemployment Tax.

[158] IRC section 280C(e).

[159] IRC section 38(c).

New Federal Law (IRC section 45N)

The provision extends the credit for one year, through taxable years beginning on or before December 31, 2014.

Effective Date

The provision generally is effective for taxable years beginning after December 31, 2013.

California Law (None)

California does not conform to the mine rescue team training credit.

Impact on California Revenue

Not applicable.

Section	Section Title
118	Extension of Employer Wage Credit for Employees Who Are Active Duty Members of the Uniformed Services

Background

Differential Pay

In general, compensation paid by an employer to an employee is deductible by the employer under IRC section 162(a)(1), unless the expense must be capitalized. In the case of an employee who is called to active duty with respect to the armed forces of the United States, some employers voluntarily pay the employee the difference between the compensation that the employer would have paid to the employee during the period of military service less the amount of pay received by the employee from the military. This payment by the employer is often referred to as "differential pay."

Wage Credit for Differential Pay

If an employer qualifies as an eligible small business employer, the employer is allowed to take a credit against its income tax liability for a taxable year in an amount equal to 20 percent of the sum of the eligible differential wage payments for each of the employer's qualified employees for the taxable year.[160]

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[160] IRC section 45P.

An eligible small business employer means, with respect to a taxable year, any taxpayer that: (1) employed on average less than 50 employees on business days during the taxable year, and (2) under a written plan of the taxpayer, provides eligible differential wage payments to every qualified employee of the taxpayer. Taxpayers under common control are aggregated for purposes of determining whether a taxpayer is an eligible small business employer. The credit is not available with respect to a taxpayer who has failed to comply with the employment and reemployment rights of members of the uniformed services (as provided under Chapter 43 of Title 38 of the United States Code).

Differential wage payment means any payment that: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services of the United States while on active duty for a period of more than 30 days, and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer. The term eligible differential wage payments means so much of the differential wage payments paid to a qualified employee as does not exceed $20,000. A qualified employee is an individual who has been an employee for the 91-day period immediately preceding the period for which any differential wage payment is made.

No deduction may be taken for that portion of compensation which is equal to the credit. In addition, the amount of any other credit otherwise allowable with respect to compensation paid to an employee must be reduced by the differential wage payment credit allowed with respect to such employee.

The differential wage payment credit is part of the general business credit, and thus this credit is subject to the rules applicable to business credits. For example, an unused credit generally may be carried back to the taxable year that precedes an unused credit year or carried forward to each of the 20 taxable years following the unused credit year. Further, the credit is not allowable against a taxpayer’s alternative minimum tax liability.

Rules similar to the rules in IRC section 52(c), which bars the work opportunity tax credit for tax-exempt organizations other than certain farmer's cooperatives, apply to the differential wage payment credit. Additionally, rules similar to the rules in IRC section 52(e), which limits the work opportunity tax credit allowable to regulated investment companies, real estate investment trusts, and certain cooperatives, apply to the differential wage payment credit.

The credit is available with respect to amounts paid after June 17, 2008,[161] and before January 1, 2014.

New Federal Law (IRC section 45P)

The provision extends the availability of the credit to amounts paid before January 1, 2015.

[161] This date is the date of enactment of the Heroes Earnings Assistance and Relief Tax Act of 2008, Public Law 110-245.

Effective Date

The provision applies to payments made after December 31, 2013.

California Law (None)

California does not conform to the employer wage credit for employees who are active duty members of the uniformed services.

Impact on California Revenue

Not applicable.

Section	Section Title
119	Extension of Work Opportunity Tax Credit

Background

In General

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted Groups Eligible for the Credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group, which include:

(1) Families Receiving TANF

An eligible recipient is an individual certified by a designated local employment agency (e.g., a state employment agency) as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families Program ("TANF") for a period of at least nine months part of which is during the 18-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the TANF.

(2) Qualified Veteran

Prior to enactment of the "VOW to Hire Heroes Act of 2011" (the "VOW Act"),[162] there were two subcategories of qualified veterans to whom wages paid by an employer were eligible for the credit. Employers who hired veterans who were eligible to receive assistance under a supplemental nutritional assistance program were entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages paid to such individual.[163] Employers who hired veterans who were entitled to compensation for a service-connected disability were entitled to a maximum wage credit of 40 percent of $12,000 of qualified first-year wages paid to such individual.[164]
The VOW Act modified the work opportunity credit with respect to qualified veterans, by adding additional subcategories. There are now five subcategories of qualified veterans: (1) in the case of veterans who were eligible to receive assistance under a supplemental nutritional assistance program (for at least a three month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service-connected disability, and who has been unemployed for an aggregate of at least six months during the one year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

A veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not a qualified veteran if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to

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[162] Public Law 112–56 (November 21, 2011).

[163] For these purposes, a qualified veteran must be certified by the designated local agency as a member of a family receiving assistance under a supplemental nutrition assistance program under the Food and Nutrition Act of 2008 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for a supplemental nutrition assistance program under the Food and Nutrition Act of 2008.

[164] The qualified veteran must be certified as entitled to compensation for a service-connected disability and: (1) have a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States, or (2) have been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. For these purposes, being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S. Code, which means having a disability rating of 10 percent or higher for service connected injuries.

prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(3) Qualified Ex-Felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any state or federal law, and (2) having a hiring date within one year of release from prison or the date of conviction.

(4) Designated Community Resident

A designated community resident is an individual certified as being at least age 18 but not yet age 40 on the hiring date and as having a principal place of abode within an empowerment zone, enterprise community, renewal community, or a rural renewal community. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined by the Office of Management and Budget) which had a net population loss during the five-year periods 1990–1994 and 1995–1999. Qualified wages do not include wages paid or incurred for services performed after the individual moves outside an empowerment zone, enterprise community, renewal community, or a rural renewal community.

(5) Vocational Rehabilitation Referral

A vocational rehabilitation referral is an individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing: (a) vocational rehabilitation services under an individualized, written plan for employment under a state plan approved under the Rehabilitation Act of 1973, (b) under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code, or (c) an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(6) Qualified Summer Youth Employee

A qualified summer youth employee is an individual: (1) who performs services during any 90-day period between May 1 and September 15, (2) who is certified by the designated local agency as being 16 or 17 years of age on the hiring date, (3) who has not been an employee of that employer before, and (4) who is certified by the designated local agency as having a principal place of abode within an empowerment zone, enterprise community, or renewal community. As with designated community residents, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone, enterprise community, or renewal community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

(7) Qualified Supplemental Nutrition Assistance Program Benefits Recipient

A qualified supplemental nutrition assistance program benefits recipient is an individual at least age 18 but not yet age 40 certified by a designated local employment agency as being a member of a family receiving assistance under a food and nutrition program under the Food and Nutrition Act of 2008 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food and nutrition assistance under section 6(o) of the Food and Nutrition Act of 2008, the six-month requirement is replaced with a requirement that the family has been receiving food and nutrition assistance for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food and nutrition assistance program under the Food and Nutrition Act of 2008.

(8) Qualified SSI Recipient

A qualified SSI recipient is an individual designated by a local agency as receiving supplemental security income (SSI) benefits under Title XVI of the Social Security Act for any month ending within the 60-day period ending on the hiring date.

(9) Long-Term Family Assistance Recipient

A qualified long-term family assistance recipient is an individual certified by a designated local agency as being: (1) a member of a family that has received family assistance for at least 18 consecutive months ending on the hiring date, (2) a member of a family that has received such family assistance for a total of at least 18 months (whether or not consecutive) after August 5, 1997 (the date of enactment of the welfare-to-work tax credit)[165] if the individual is hired within two years after the date that the 18-month total is reached, or (3) a member of a family who is no longer eligible for family assistance because of either federal or state time limits, if the individual is hired within two years after the federal or state time limits made the family ineligible for family assistance.

Qualified Wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit. For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in IRC section 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

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[165] The welfare-to-work tax credit was consolidated into the work opportunity tax credit in the Tax Relief and Health Care Act of 2006, Public Law 109–432, for qualified individuals who begin to work for an employer after December 31, 2006.

Calculation of the Credit

The credit available to an employer for qualified wages paid to members of all targeted groups except for long-term family assistance recipients equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

For calculation of the credit with respect to qualified veterans, see the description of "qualified veteran" above.

Certification Rules

Generally, an individual is not treated as a member of a targeted group unless: (1) on or before the day on which an individual begins work for an employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group, or (2) on or before the day an individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and not later than the 28th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. For these purposes, a pre-screening notice is a document (in such form as the Secretary may prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

An otherwise qualified unemployed veteran is treated as certified by the designated local agency as having aggregate periods of unemployment (whichever is applicable under the qualified veterans rules described above) if such veteran is certified by such agency as being in receipt of unemployment compensation under a state or federal law for such applicable periods. The Secretary of the Treasury is authorized to provide alternative methods of certification for unemployed veterans.

Minimum Employment Period

No credit is allowed for qualified wages paid to employees who work less than 120 hours in the first year of employment.

Qualified Tax-Exempt Organizations Employing Qualified Veterans

The credit is not available to qualified tax-exempt organizations other than those employing qualified veterans. The special rules, described below, were enacted in the "VOW to Hire Heroes Act of 2011" (the "VOW Act.")

If a qualified tax-exempt organization employs a qualified veteran (as described above), a tax credit against the FICA taxes of the organization is allowed on the wages of the qualified veteran which are paid for the veteran's services in furtherance of the activities related to the function or purpose constituting the basis of the organization's exemption under IRC section 501.

The credit available to such tax-exempt employer for qualified wages paid to a qualified veteran equals 26 percent (16.25 percent for employment of 400 hours or less) of qualified first-year wages. The amount of qualified first-year wages eligible for the credit is the same as those for non-tax-exempt employers (i.e., $6,000, $12,000, $14,000 or $24,000, depending on the category of qualified veteran).

A qualified tax-exempt organization means an employer that is described in IRC section 501(c) and exempt from tax under IRC section 501(a).

The Social Security Trust Funds are held harmless from the effects of this provision by a transfer from the Treasury General Fund.

Treatment of Possessions

The VOW Act provided a reimbursement mechanism for the U.S. possessions (American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the United States Virgin Islands). The Treasury Secretary is to pay to each mirror code possession (Guam, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands) an amount equal to the loss to that possession as a result of the VOW Act changes to the qualified veterans rules. Similarly, the Treasury Secretary is to pay to each non-mirror IRC possession (American Samoa and the Commonwealth of Puerto Rico) the amount that the Secretary estimates as being equal to the loss to that possession that would have occurred as a result of the VOW Act changes if a mirror code tax system had been in effect in that possession. The Secretary will make this payment to a non-mirror IRC possession only if that possession establishes to the satisfaction of the Secretary that the possession has implemented (or, at the discretion of the Secretary, will implement) an income tax benefit that is substantially equivalent to the qualified veterans credit allowed under the VOW Act modifications.

An employer that is allowed a credit against U.S. tax under the VOW Act with respect to a qualified veteran must reduce the amount of the credit claimed by the amount of any credit (or, in the case of a non-mirror IRC possession, another tax benefit) that the employer claims against its possession income tax.

Other Rules

The work opportunity tax credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than 50-percent owner of the entity. Similarly, wages that are paid to replacement workers during a strike or lockout are not eligible for the work opportunity tax credit. Wages paid to any employee during any period for which the employer received on-the-job training program payments with respect to that employee are not eligible for the work opportunity tax credit. The work opportunity tax credit generally is not allowed for wages paid to individuals who had previously been employed by the employer. In addition, many other technical rules apply.

Expiration

Generally, the work opportunity tax credit is not available for individuals who begin work for an employer after December 31, 2013.

<u>New Federal Law (IRC section 51)</u>

The credit is extended for one year, through December 31, 2014.

<u>Effective Date</u>

The provision is effective for individuals who begin work for the employer after December 31, 2013.

<u>California Law</u>

California does not conform to the federal work opportunity tax credit allowed under IRC section 51. However, the following California hiring credits[166] are reduced by the amount of an employer's federal work opportunity tax credit: (1) the enterprise zone credit,[167] (2) the manufacturing enhancement area credit,[168] and (3) the local agency military base recovery area

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[166] For employees employed by taxpayers within the 60-month period immediately preceding January 1, 2014, California law provides hiring credits for taxpayers conducting business activities within geographically targeted economic development areas (EDAs). Employers located in an EDA (i.e., qualified employers) are eligible for hiring credits equal to a percentage of wages paid to individuals from targeted groups (i.e., qualified employees). EDAs impacted by this provision are enterprise zones (EZs), manufacturing enhancement areas (MEAs), and local agency military base recovery areas (LAMBRAs).

The California EDA hiring credits generally cease to be operative for taxable years beginning on or after January 1, 2014; however, the credits continue to apply for taxable years beginning on or after January 1, 2014, with respect to qualified employees who are employed by qualified taxpayers within the 60-month period immediately preceding that date (Chapter 69 of the Statutes of 2013).

[167] R&TC sections 17053.74(b)(4)(A)(iv)(XI) and 23622.7(b)(4)(A)(iv)(XI).

[168] R&TC sections 17053.47(f) and 23622.8(e).

credit.[169] Because the reduction to the California hiring credits is the amount of the federal work opportunity tax credits allowed under IRC section 51 as of the "specified date" of January 1, 2009, the California hiring credits are not reduced by any federal work opportunity tax credits enacted or extended after that "specified date," including the work opportunity tax credits extended by this provision.

Impact on California Revenue

Estimated Conformity Revenue Impact of Extension of Work Opportunity Tax Credit For Taxable Years Beginning On or After January 1, 2015 Enactment Assumed After June 30, 2015		
2015-16	2016-17	2017-18
$10,000,000	$2,300,000	$900,000

This estimate is based on a proration of the federal estimate developed for this provision by the Joint Committee on Taxation.

Section Section Title

120 Extension of Qualified Zone Academy Bonds

Background

Tax-Exempt Bonds

Interest on state and local governmental bonds generally is excluded from gross income for federal income tax purposes if the proceeds of the bonds are used to finance direct activities of these governmental units or if the bonds are repaid with revenues of the governmental units. These can include tax-exempt bonds which finance public schools.[170] An issuer must file with the Internal Revenue Service certain information about the bonds issued in order for that bond issue to be tax-exempt.[171] Generally, this information return is required to be filed no later the 15th day of the second month after the close of the calendar quarter in which the bonds were issued.

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[169] R&TC sections 17053.46(g) and 23646(g).

[170] IRC section 103.

[171] IRC section 149(e).

The tax exemption for state and local bonds does not apply to any arbitrage bond.[172] An arbitrage bond is defined as any bond that is part of an issue if any proceeds of the issue are reasonably expected to be used (or intentionally are used) to acquire higher-yielding investments or to replace funds that are used to acquire higher-yielding investments.[173] In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the federal government.

Qualified Zone Academy Bonds

As an alternative to traditional tax-exempt bonds, states and local governments were given the authority to issue "qualified zone academy bonds."[174]

A total of $400 million of qualified zone academy bonds is authorized to be issued annually in calendar years 1998 through 2008, $1,400 million in 2009 and 2010, and $400 million in 2011, 2012, and 2013. Each calendar year's bond limitation is allocated to the states according to their respective populations of individuals below the poverty line. Each state, in turn, allocates the credit authority to qualified zone academies within such state.

A taxpayer holding a qualified zone academy bond on the credit allowance date is entitled to a credit. The credit is includible in gross income (as if it were a taxable interest payment on the bond), and may be claimed against regular income tax and alternative minimum tax liability.

Qualified zone academy bonds are a type of qualified tax credit bond and subject to the general rules applicable to qualified tax credit bonds.[175] The Treasury Department sets the credit rate at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer.[176] The Secretary of the Treasury determines credit rates for tax credit bonds based on general assumptions about credit quality of the class of potential eligible issuers and such other factors as the Secretary deems appropriate. The Secretary may determine credit rates based on general credit market yield indexes and credit ratings. The maximum term of the bond is determined by the Treasury Department, so that the present value of the obligation to repay the principal on the bond is 50 percent of the face value of the bond.

"Qualified zone academy bonds" are defined as any bond issued by a state or local government, provided that: (1) at least 100 percent of the available project proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers

[172] IRC sections 103(a) and (b)(2).

[173] IRC section 148.

[174] See IRC sections 54E and 1397E.

[175] IRC section 54A.

[176] Given the differences in credit quality and other characteristics of individual issuers, the Secretary of the Treasury cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

and other school personnel in a "qualified zone academy," and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if: (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community designated under the IRC, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

New Federal Law (IRC section 54E)

The provision extends the qualified zone academy bond program for one year. The provision authorizes issuance of up to $400 million of qualified zone academy bonds per year for 2014.

Effective Date

The provision applies to obligations issued after December 31, 2013.

California Law (R&TC sections 17143 and 24272)

In General

California does not conform to IRC section 54E, relating to qualified zone academy bonds, and income from such bonds is not includible in California gross income.

California specifically does not conform to IRC sections 103 and 141 through 150, relating to the federal rules exempting the interest earned on state or municipal bonds and the arbitrage rebate rules. In addition, the federal "private-activity-bond" rules have not been adopted by California.

California State and Municipal Bonds

The general rule in California is that for income tax purposes, all interest received or accrued is fully taxable, except for interest on federal obligations (such as Treasury bills, notes, and bonds, as more fully described below) and tax-exempt bonds issued by this state or a local government in this state.

Unlike federal law, the interest earned on bonds issued by other states and municipalities in other states is fully taxable to a resident of California. The California exemption from income taxation of interest on bonds of the state and its political subdivisions is contained in the California Constitution (subdivision (b) of section 26 of Article XIII). California law further provides that the federal private-activity-bond analysis shall not be made in determining whether interest on bonds issued by the state or a political subdivision thereof is exempt from California income tax. Thus, in

California, if the use of the bond proceeds of a state or local California issue is for private business use or is secured by property used for a private business use, the interest on that bond is still treated for California income tax purposes as tax exempt, even though the interest on the bond may be taxable for federal income tax purposes.

California Conduit Revenue Bonds

Conduit revenue bonds are issued by a governmental (state or municipal) entity for various purposes, including economic development, educational and health facilities construction, and multi-family housing. The funds obtained from the financing are loaned to a non-governmental borrower who builds and operates the project. The use by a private firm (via expenditure of the bond proceeds) of a governmental agency's authority to issue tax-exempt debt is premised on the fact that the project will provide a public benefit. A conduit revenue bond is payable solely from the loan payments received from the non-governmental party (unless the bond is insured by a third party who guarantees payment in the event of a default by the private firm who has pledged the revenue source). The governmental issuer typically has no liability for debt service on the bonds, except for the administration of the bond. Although the issuer has no actual liability on the bonds, their reputation and standing with respect to future debt financing may be negatively affected in the event of a default on the bonds. More importantly, should the bonds go into default, the governmental entity will likely be drawn into the settlement process. Most conduit revenue bonds are sold at negotiated sales with the interest rate and other terms of the bonds negotiated between the issuer, the non-governmental borrower, and an underwriter. The security for some of these transactions is sufficient to allow the underwriter to act as a pass-through for the bonds and in so doing act as a placement agent rather than an underwriter. Because the public agency's credit is not at risk, many issuers do not participate in any substantive fashion in the sale of the bonds. Rather, they may limit their role to reviewing the bond purchase contract and other legal and disclosure documents to ensure that they are adequately indemnified against liabilities, and to accurately describe their role to investors as issuers and not as borrowers or guarantors of the debt.

Because the conduit revenue bonds issued in California are issued by this state or a local government in this state, the interest paid on such bonds is exempt from state income taxation under the California Constitution.

California Treatment of Federal Bond Interest

Interest earned on federal bonds is also tax-exempt for California income tax purposes. This results from federal law (31 U.S.C. § 3124(a)) that prohibits all states from imposing a discriminatory income tax on interest income from direct obligations of the federal government. Examples of bonds that are exempt for California income tax purposes include those issued by federal land banks, the Federal Home Loan Bank, and Banks for Cooperatives.

Not all federal bonds are direct obligations of the U.S. government, and interest on those bonds is taxable. Examples of federal bonds not exempt are those issued by the Federal National Mortgage Association (Fannie Maes), Government National Mortgage Association (Ginnie Maes), and Federal Loan Home Mortgage Corporation (Freddie Macs).

California Franchise Tax Treatment

Interest received from federal, state, municipal, or other bonds is includable in the gross income of corporations taxable under the franchise tax. The franchise tax is a nondiscriminatory privilege tax for the right to exercise the corporate franchise and is not a tax on the income received, but instead merely uses that income as the measure of the tax for the privilege of exercising the corporate franchise. The franchise tax is imposed on corporations doing business in the state.

Impact on California Revenue

Not applicable.

Section	Section Title
121	Extension of Classification of Certain Race Horses as 3-Year Property

Background

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system (MACRS). The class lives of assets placed in service after 1986 are generally set forth in IRC section 168.

The general recovery period for race horses is seven years. However, a special recovery period was enacted by the Heartland Habitat, Harvest, and Horticulture Act of 2008[177] that provides that any race horse that is placed in service before January 1, 2014, is assigned a three-year recovery period.[178] For race horses placed in service after December 31, 2013, a seven year recovery period is assigned to any race horse that is two years old or younger at the time it is placed in service,[179] and a three-year recovery period is assigned to any race horse that is more than two years old at the time it is placed in service.

New Federal Law (IRC section 168)

This provision extends the special three-year recovery period for race horses for one year. Any race horse that is placed in service before January 1, 2015, is assigned a three-year recovery period. For race horses placed in service after December 31, 2014, a seven year recovery period

[177] Section 15344 of Public Law 110-246.

[178] IRC section 168(e)(3)(A)(i).

[179] 1987-2 C.B. 674, asset class 01.225.

is assigned to any race horse that is two years old or younger at the time it is placed in service, and a three-year recovery period is assigned to any race horse that is more than two years old at the time it is placed in service.

Effective Date

The provision is effective for race horses placed in service after December 31, 2014.

California Law (R&TC sections 17201, 17250, and 24349)

Under the Personal Income Tax Law, for taxable years beginning on or after January 1, 2010, California law, as it relates to MACRS in general, conforms to IRC section 168 as of a specified date of January 1, 2009,[180] with modifications.[181] Thus, for taxable years beginning on or after January 1, 2010, the Personal Income Tax Law conforms to the special recovery period was enacted by the Heartland Habitat, Harvest, and Horticulture Act of 2008 that provides that any race horse that is placed in service before January 1, 2014, is assigned a three-year recovery period. However, the Personal Income Tax Law does not conform to this provision's one-year extension of the special recovery period for racehorses. For race horses placed in service after December 31, 2013, a seven year recovery period is assigned to any race horse that is two years old or younger at the time it is placed in service, and a three-year recovery period is assigned to any race horse that is more than two years old at the time it is placed in service.

Under the Corporation Tax Law, California does not conform to federal MACRS depreciation. Instead, the Corporation Tax Law is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules, which generally allow property to be depreciated based on its useful life.[182]

Impact on California Revenue

None (the federal provision expired for racehorses placed in service on or after January 1, 2015).

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[180] R&TC section 17201 conforms to IRC section 168 as of the "specified date" of January 1, 2009.

[181] R&TC section 17250.

[182] R&TC sections 24349-24355.4.

Section	Section Title
122	Extension of 15-Year Straight-Line Cost Recovery for Qualified Leasehold Improvements, Qualified Restaurant Buildings and Improvements, and Qualified Retail Improvements

Background

In General

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[183] The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month.

Depreciation of Leasehold Improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease. This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

Qualified Leasehold Improvement Property

IRC section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property placed in service before January 1, 2014. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[184] The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is

[183] IRC section 168.

[184] IRC section 168(e)(6).

attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Qualified leasehold improvement property is recovered using the straight-line method and a half-year convention. Qualified leasehold improvement property placed in service after December 31, 2013, is subject to the general rules described above.

Qualified Restaurant Property

IRC section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property placed in service before January 1, 2014. Qualified restaurant property is any IRC section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.[185] Qualified restaurant property is recovered using the straight-line method and a half-year convention. Additionally, qualified restaurant property is not eligible for bonus depreciation.[186] Qualified restaurant property placed in service after December 31, 2013, is subject to the general rules described above.

Qualified Retail Improvement Property

IRC section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property placed in service before January 1, 2014. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public[187] and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.[188] Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.

[185] IRC section 168(e)(7).

[186] Property that satisfies the definition of both qualified leasehold improvement property and qualified restaurant property is eligible for bonus depreciation.

[187] Improvements to portions of a building not open to the general public (e.g., stock room in back of retail space) do not qualify under the provision.

[188] IRC section 168(e)(8).

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.

Qualified retail improvement property is recovered using the straight-line method and a half-year convention. Additionally, qualified retail improvement property is not eligible for bonus depreciation.[189] Qualified retail improvement property placed in service after December 31, 2013, is subject to the general rules described above.

New Federal Law (IRC section 168)

The present law provisions for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property are extended for one year to apply to property placed in service on or before December 31, 2014.

Effective Date

The provision is effective for property placed in service after December 31, 2013.

California Law (R&TC sections 17201, 17250, and 24349-24355.4)

This provision is not applicable under California law.

The Personal Income Tax Law generally conforms to MACRS, with modifications, but specifically does not conform to the MACRS exception that allows 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvements.[190]

The Corporation Tax Law does not adopt MACRS. Instead, the Corporation Tax Law is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules, which generally allow property to be depreciated based on its useful life.[191] Additionally, the Corporation Tax Law allows the use of component depreciation.[192]

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[189] Property that satisfies the definition of both qualified leasehold improvement property and qualified retail property is eligible for bonus depreciation.

[190] R&TC section 17250(a)(6).

[191] R&TC sections 24349-24355.4.

[192] Prior to the adoption of accelerated cost recovery system (ACRS) by the Economic Recovery Tax Act of 1981, federal law allowed taxpayers to depreciate various components of a building as separate assets with separate useful

Impact on California Revenue

Not applicable.

Section	Section Title
123	Extension of 7-Year Recovery Period for Motorsports Entertainment Complexes

Background

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS), which determines depreciation by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property.[193]

The cost of nonresidential real property is recovered using the straight-line method of depreciation and a recovery period of 39 years. Nonresidential real property is subject to the mid-month placed-in-service convention. Under the mid-month convention, the depreciation allowance for the first year property is placed in service is based on the number of months the property was in service, and property placed in service at any time during a month is treated as having been placed in service in the middle of the month. Land improvements (such as roads and fences) are recovered over 15 years. An exception exists for the theme and amusement park industry, whose assets are assigned a recovery period of seven years. Additionally, a motorsports entertainment complex placed in service on or before December 31, 2013, is assigned a recovery period of seven years.[194] For these purposes, a motorsports entertainment complex means a racing track facility which is permanently situated on land and which during the 36-month period following its placed-in-service date hosts a racing event.[195] The term motorsports entertainment complex also includes ancillary facilities, land improvements (e.g., parking lots, sidewalks, fences), support facilities (e.g., food and beverage retailing, souvenir vending), and appurtenances associated with such facilities (e.g., ticket booths, grandstands, etc.).

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lives, known as “component depreciation.” The Corporation Tax Law has never been amended to repeal the use of component depreciation, and has never adopted ACRS or MACRS.

[193] IRC section 168.

[194] IRC section 168(e)(3)(C)(ii).

[195] IRC section 168(i)(15).

New Federal Law (IRC section 168)

The provision extends the seven-year recovery period for motorsports entertainment complexes for one year to apply to property placed in service before January 1, 2015.

California Law (R&TC sections 17250 and 24349)

This provision is not applicable under California law.

The Personal Income Tax Law generally conforms to MACRS, with modifications. Regarding the recovery period for motorsports entertainment complexes, the Personal Income Tax Law conformed to the seven-year recovery period for property placed in service on or after January 1, 2005, and before December 31, 2007,[196] and specifically does not conform to the seven-year recovery period for property placed in service on or after January 1, 2008.[197]

The Corporation Tax Law does not adopt MACRS. Instead, the Corporation Tax Law is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules, which generally allow property to be depreciated based on its useful life.[198]

The Corporation Tax Law temporarily adopted the seven-year recovery period for motorsports entertainment complexes, for property placed in service on or after January 1, 2005, and before December 31, 2007,[199] but that seven-year recovery period is not allowed for property placed in service on or after January 1, 2008.

Impact on California Revenue

Not applicable.

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[196] For taxable years beginning on or after January 1, 2005, and before January 1, 2010, the Personal Income Tax Law conformed to the IRC section 168(i)(15) seven-year recovery period under RT&C section 17250, as of the "specified date" of January 1, 2005; thus, California conformed to the December 31, 2007, termination date contained in IRC section 168(i)(15) that applied as of January 1, 2005.

[197] R&TC section 17250(a)(11).

[198] R&TC sections 24349-24355.4.

[199] Former R&TC section 24355.3, as added by Chapter 691 of the Statutes of 2005, allowed the seven-year recovery period under the Corporation Tax Law for the same period that was allowed under the Personal Income Tax Law, for property placed in service on or after January 1, 2005, and before December 31, 2007. Former R&TC section 24355.3 was repealed by Section 68 of Chapter 14 of the Statutes of 2010.

Section	Section Title
124	Extension of Accelerated Depreciation for Business Property on an Indian Reservation

Background

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions under IRC section 168(j) are determined using the following recovery periods:

3-year property	2 years
5-year property	3 years
7-year property	4 years
10-year property	6 years
15-year property	9 years
20-year property	12 years
Nonresidential real property	22 years

"Qualified Indian reservation property" eligible for accelerated depreciation includes property described in the table above which is: (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation, (2) not used or located outside the reservation on a regular basis, (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer,[200] and (4) is not property placed in service for purposes of conducting gaming activities.[201] Certain "qualified infrastructure property" may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities).[202]

An "Indian reservation" means a reservation as defined in section 3(d) of the Indian Financing Act of 1974[203] or section 4(10) of the Indian Child Welfare Act of 1978 (25 U.S.C. 1903(10)).[204] For purposes of the preceding sentence, section 3(d) is applied by treating "former Indian reservations in Oklahoma" as including only lands that are (1) within the jurisdictional area of an Oklahoma Indian tribe as determined by the Secretary of the Interior, and (2) recognized by such Secretary as an area eligible for trust land status under 25 C.F.R. Part 151 (as in effect on August 5, 1997).

200 For these purposes, "related persons" is defined in IRC section 465(b)(3)(C).

201 IRC section 168(j)(4)(A).

202 IRC section 168(j)(4)(C).

203 Public Law 93–262.

204 Public Law 95–608.

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax. The accelerated depreciation for qualified Indian reservation property is available with respect to property placed in service before January 1, 2014.

New Federal Law (IRC section 168)

The provision extends for one year the accelerated MACRS recovery periods for qualified Indian reservation property to apply to property placed in service before January 1, 2015.

Effective Date

The provision is effective for property placed in service after December 31, 2013.

California Law (R&TC sections 17250 and 24349-24355.4)

This provision is not applicable under California law.

The Personal Income Tax Law generally conforms to MACRS recovery periods, but specifically does not conform to accelerated depreciation for business property on an Indian Reservation.[205]

The Corporation Tax Law does not adopt MACRS. The Corporation Tax Law is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules, which generally allow property to be depreciated based on its "useful life."[206]

Impact on California Revenue

Not applicable.

Section	Section Title
125	Extension of Bonus Depreciation

Background

In General

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property placed in service between January 1, 2008, and September 8, 2010, or between January 1, 2012, and January 1, 2014 (January 1, 2015, for certain longer-lived and transportation property).[207]

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[205] R&TC section 17250(a)(3).

[206] R&TC sections 24349-24355.4.

[207] IRC section 168(k). The additional first-year depreciation deduction is subject to the general rules regarding whether an item must be capitalized under IRC section 263 or IRC section 263A.

An additional first-year depreciation deduction is allowed equal to 100 percent of the adjusted basis of qualified property if it meets the requirements for the additional first-year depreciation and also meets the following requirements. First, the taxpayer must acquire the property after September 8, 2010, and before January 1, 2012 (January 1, 2013, for certain longer-lived and transportation property).[208] Second, the taxpayer must place the property in service after September 8, 2010, and before January 1, 2012 (January 1, 2013, in the case of certain longer-lived and transportation property). Third, the original use of the property must commence with the taxpayer after September 8, 2010.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes, but is not allowed for purposes of computing earnings and profits. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2012, a taxpayer purchased new depreciable property and placed it in service.[209] The property's cost is $1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed is $500. The remaining $500 of the cost of the property is depreciable under the rules applicable to five-year property. Thus, 20 percent, or $100, is also allowed as a depreciation deduction in 2012. The total depreciation deduction with respect to the property for 2012 is $600. The remaining $400 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements. First, the property must be: (1) property to which the modified accelerated cost recovery system (MACRS) applies with an applicable recovery period of 20 years or less; (2) water utility property (as defined in IRC section 168(e)(5)); (3) computer software other than computer software covered by IRC section 197; or (4) qualified leasehold improvement property (as defined in IRC section 168(k)(3)).[210] Second, the original use[211] of the property must

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[208] For a definition of "acquire" for this purpose, see section 3.02(1)(a) of Rev. Proc. 2011–26, 2011–16 I.R.B. 664.

[209] Assume that the cost of the property is not eligible for expensing under IRC section 179.

[210] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. The additional first-year depreciation deduction is also not available for qualified New York Liberty Zone leasehold improvement property as defined in IRC section 1400L(c)(2).

[211] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in

commence with the taxpayer after December 31, 2007.[212] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2014. An extension of the placed-in-service date of one year (i.e., January 1, 2015) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.[213]

To qualify, property must be acquired: (1) after December 31, 2007, and before January 1, 2014, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into after December 31, 2007, and before January 1, 2014.[214] With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2014. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2014 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[215]

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner. For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to

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property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

[212] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

[213] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one-year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service-date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

[214] Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

[215] For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to IRC section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation under IRC section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year deduction).[216] The $8,000 increase is not indexed for inflation.

Special Rule for Long-Term Contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method. Solely for purposes of determining the percentage of completion under IRC section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service after December 31, 2002, and before January 1, 2014 (January 1, 2015, in the case of certain longer-lived and transportation property). Bonus depreciation is taken into account in determining taxable income under the percentage-of-completion method for property placed in service after December 31, 2010.

Election to Accelerate Minimum Tax Credit in Lieu of Claiming Bonus Depreciation

A corporation otherwise eligible for additional first-year depreciation under IRC section 168(k) may elect to claim additional minimum tax credits in lieu of claiming deprecation under IRC section 168(k) for “eligible qualified property” placed in service after December 31, 2010, and before January 1, 2014 (January 1, 2015, in the case of certain longer-lived and transportation property).[217] A corporation making the election increases the limitation under IRC section 53(c) on the use of minimum tax credits in lieu of taking bonus depreciation deductions. The increases in the allowable credits under this provision are treated as refundable. The depreciation for eligible qualified property is calculated for both regular tax and alternative minimum tax purposes using the straight-line method in place of the method that would otherwise be used absent the election under this provision.

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[216] IRC section 168(k)(2)(F).

[217] IRC section 168(k)(4). Eligible qualified property means qualified property eligible for bonus depreciation with minor effective date differences.

The minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20 percent of bonus depreciation[218] for certain eligible qualified property that could be claimed as a deduction absent an election under this provision.

The bonus depreciation amount is limited to the lesser of: (1) $30 million, or (2) six-percent of the minimum tax credits allocable to the adjusted minimum tax, imposed for taxable years beginning before January 1, 2006. All corporations treated as a single employer under IRC section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, IRC section 168(k)(1) does not apply to any eligible qualified property and the straight-line method is used with respect to such property.

Generally an election under this provision for a taxable year applies to subsequent taxable years.[219]

Normalization Accounting

Under present law, in order for public utility property to qualify for certain accelerated depreciation allowances for federal income tax purposes, the benefits of accelerated depreciation must be normalized.[220] Normalization accounting as applied to accelerated tax depreciation generally requires regulatory tax expense to be computed using the depreciation methods and periods used for regulatory, rather than federal income tax, purposes. Any deferred tax reserve resulting from the use of the normalization method of accounting may be used to reduce the rate base upon which a utility earns its rate of return.

New Federal Law (IRC sections 168, 460, 1400L, and 1400N)

The provision extends the 50-percent additional first-year depreciation deduction for one year, generally through 2014 (through 2015 for certain longer-lived and transportation property).

The provision provides that solely for purposes of determining the percentage of completion under IRC section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of 7 years or less which is placed in service after December 31, 2013, and before January 1, 2015

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218 For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation for all eligible qualified property determined if IRC section 168(k)(1) applied using the most accelerated depreciation method (determined without regard to this provision), and the shortest life allowable for each property, and (ii) the amount of depreciation that would be determined if IRC section 168(k)(1) did not apply using the same method and life for each property.

219 Special election rules apply as the result of prior extensions of this provision.

220 IRC section 168(i)(9).

(January 1, 2016, in the case of certain longer-lived and transportation property), is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted.

The provision also generally permits a corporation to increase the minimum tax credit limitation by the bonus depreciation amount with respect to certain property placed in service after December 31, 2013, and before January 1, 2015 (January 1, 2016, in the case of certain longer-lived and transportation property). The provision applies with respect to "round-4 extension property," which is defined as property that is eligible qualified property solely because it meets the requirements under the extension of the additional first-year depreciation deduction for certain property placed in service after December 31, 2014.[221]

Under the provision, a corporation that has previously made an election to claim credits in lieu of bonus depreciation may choose not to make this previous election apply for round-4 extension property. The provision also allows a corporation that has not made a previous election to claim credits in lieu of bonus deprecation to make the election for round-4 extension property for its first taxable year ending after December 31, 2013, and for each subsequent year. A separate bonus depreciation amount, maximum amount, and maximum increase amount is computed and applied to round-4 extension property.[222]

Effective Date

The provision is effective for property placed in service after December 31, 2013, in taxable years ending after such date.

California Law (R&TC sections 17201, 17250, and 24349)

This provision is not applicable under California law.

The Personal Income Tax Law generally conforms to MACRS as of the "specified date" of January 1, 2009,[223] but specifically does not conform to bonus depreciation.[224]

The Corporation Tax Law does not adopt MACRS, and instead is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules that generally allow property to be depreciated based on its "useful life."[225]

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[221] An election under new IRC section 168(k)(4)(K) with respect to round 4 extension property is binding for any property that is eligible qualified property solely by reason of the amendments made by section 125(a) of the Act (and the application of such extension to this paragraph pursuant to the amendment made by section 125(c)(1) of the Act), even if such property is placed in service in 2015.

[222] In computing the maximum amount, the maximum increase amount for round 3 extension property is reduced by bonus depreciation amounts for preceding taxable years only with respect to round 3 extension property.

[223] R&TC section 17201 conforms to MACRS under IRC section 168 as of the "specified date" of January 1, 2009, with modifications.

[224] R&TC section 17250(a)(2)(C)(4).

[225] R&TC section 24349.

Impact on California Revenue

Not applicable.

Section	Section Title
126	Extension of Enhanced Charitable Deduction for Contributions of Food Inventory

Background

Charitable Contributions in General

In general, an income tax deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization.[226]

Charitable contributions of cash are deductible in the amount contributed. In general, contributions of capital gain property are deductible at fair market value with certain exceptions. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of other appreciated property generally are deductible at the donor's basis in the property. Contributions of depreciated property generally are deductible at the fair market value of the property.

General Rules Regarding Contributions of Inventory

Under present law, a taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less, the fair market value of the inventory.

For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one-half of the item's appreciation (i.e., basis plus one-half of fair market value in excess of basis) or (2) two times basis.[227] In general, a C corporation's charitable contribution deductions for a year may not exceed 10 percent of the corporation's taxable income.[228] To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer and must be contributed to a charitable organization described in

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[226] IRC section 170.

[227] IRC section 170(e)(3).

[228] IRC section 170(b)(2).

IRC section 501(c)(3) (except for private non-operating foundations), and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.[229] In the case of contributed property subject to the Federal Food, Drug, and Cosmetic Act, as amended, the property must satisfy the applicable requirements of such Act on the date of transfer and for 180 days prior to the transfer.[230]

A donor making a charitable contribution of inventory must make a corresponding adjustment to the cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the property or the donor's basis with respect to the inventory.[231]

To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis. The valuation of food inventory has been the subject of disputes between taxpayers and the IRS.[232]

Temporary Rule Expanding and Modifying the Enhanced Deduction for Contributions of Food Inventory

Under a special temporary provision, any taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for donations of food inventory.[233] For taxpayers other than C corporations, the total deduction for donations of food inventory in a taxable year generally may not exceed 10 percent of the taxpayer's net income for such taxable year from all sole proprietorships, S corporations, or partnerships (or other non C corporations) from which contributions of apparently wholesome food are made. For example, if a taxpayer is a sole proprietor, a shareholder in an S corporation, and a partner in a partnership, and each business makes charitable contributions of food inventory, the taxpayer's deduction for donations of food inventory is limited to 10 percent of the taxpayer's net income from the sole proprietorship and the taxpayer's interests in the S corporation and partnership. However, if only the sole proprietorship and the S corporation made charitable contributions of food inventory, the taxpayer's deduction would be limited to 10 percent of the net income from the trade or business of the sole proprietorship and the taxpayer's interest in the S corporation, but not the taxpayer's interest in the partnership.[234]

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[229] IRC section 170(e)(3)(A)(i)-(iii).

[230] IRC section 170(e)(3)(A)(iv).

[231] Treas. Reg. section 1.170A–4A(c)(3).

[232] *Lucky Stores Inc. v. Commissioner*, 105 T.C. 420 (1995) (holding that the value of surplus bread inventory donated to charity was the full retail price of the bread rather than half the retail price, as the IRS asserted).

[233] IRC section 170(e)(3)(C).

[234] The 10-percent limitation does not affect the application of the generally applicable percentage limitations. For example, if 10 percent of a sole proprietor's net income from the proprietor's trade or business was greater than 50 percent of the proprietor's contribution base, the available deduction for the taxable year (with respect to contributions to public charities) would be 50 percent of the proprietor's contribution base. Consistent with present

Under the temporary provision, the enhanced deduction for food is available only for food that qualifies as "apparently wholesome food." Apparently wholesome food is defined as food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws and regulations even though the food may not be readily marketable due to appearance, age, freshness, grade, size, surplus, or other conditions.

The temporary provision does not apply to contributions made after December 31, 2013.

New Federal Law (IRC section 170)

The provision extends the expansion of, and modifications to, the enhanced deduction for charitable contributions of food inventory to contributions made before January 1, 2015.

Effective Date

The provision is effective for contributions made after December 31, 2013.

California Law (R&TC sections 17201, 17275.2, 17275.5, and 24357–24359.1)

This provision is not applicable under California law.

The Personal Income Tax Law generally conforms to the federal rules relating to charitable contributions as of the "specified date" of January 1, 2009,[235] but specifically does not conform to the enhanced deduction for a contribution of food inventory.[236] The deduction under the Personal Income Tax Law for charitable contributions of inventory is limited to the taxpayer's basis in the inventory, generally its cost.

The Corporation Tax Law does not adopt the general federal rules that allow enhanced deductions for C-corporation contributions of inventory, and does not adopt the enhanced deduction for a contribution of food inventory. The deduction under the Corporation Tax Law for contributions of inventory is limited to the taxpayer's basis in the inventory (generally its cost), and may not exceed ten percent of the corporation's net income. Any excess may be carried forward for up to five years.[237]

law, such contributions may be carried forward because they exceed the 50 percent limitation. Contributions of food inventory, by a taxpayer that is not a C corporation, that exceed the 10 percent limitation but not the 50 percent limitation, could not be carried forward.

[235] R&TC section 17201 conforms to IRC section 170, relating to charitable contributions and gifts, as of the "specified date" of January 1, 2009, with modifications.

[236] R&TC section 17275.2.

[237] R&TC sections 24357–24359.1.

Impact on California Revenue

Not applicable.

Section	Section Title
127	Extension of Increased Expensing Limitations and Treatment of Certain Real Property as Section 179 Property

Background

A taxpayer may elect under IRC section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation.[238] For taxable years beginning in 2012 and 2013, is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000. Of the $500,000 expense amount available, the maximum amount available with respect to qualified real property is $250,000 for each taxable year.

In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2014 also is treated as qualifying property.

For taxable years beginning in 2014 and thereafter, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year, subject to limitation. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation. In general, qualifying property is defined as depreciable tangible personal property (not including off-the-shelf computer software) that is purchased for use in the active conduct of a trade or business.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations). However, amounts attributable to qualified real property that are disallowed under the trade or business income limitation may only be carried over to taxable years in which the definition of eligible IRC section 179 property includes qualified real property.[239] Thus, if a taxpayer's IRC-

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[238] Additional IRC section 179 incentives have been provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (IRC section 1397A), a renewal community (IRC section 1400J), or the Gulf Opportunity Zone (IRC section 1400N(e)). In addition, IRC section 179(e) provides for an enhanced IRC section 179 deduction for qualified disaster assistance property.

[239] IRC section 179(f)(4) details the special rules that apply to disallowed amounts.

section-179 deduction for 2012 with respect to qualified real property is limited by the taxpayer's active trade or business income, then such disallowed amount may be carried over to 2013. Any such carryover amounts that are not used in 2013 are treated as property placed in service in 2013 for purposes of computing depreciation. That is, the unused carryover amount from 2012 is considered placed in service on the first day of the 2013 taxable year.[240]

No general business credit under IRC section 38 is allowed with respect to any amount for which a deduction is allowed under IRC section 179. An expensing election is made under rules prescribed by the Secretary of the Treasury.[241] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Secretary of the Treasury. However, an election or specification under IRC section 179 may be revoked by the taxpayer without consent of the Secretary of the Treasury for taxable years beginning after 2002 and before 2013.[242]

New Federal Law (IRC section 179)

The provision provides that the maximum amount a taxpayer may expense for taxable years beginning in 2014 is $500,000 of the cost of qualifying property placed in service for the taxable year. The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000.

In addition, the provision extends, for taxable years beginning in 2014, the treatment of off-the-shelf computer software as qualifying property. The provision also extends through 2014 the treatment of qualified real property as eligible IRC-section-179 property, including the limitation on carryovers and the maximum amount of $250,000 for each taxable year.

Effective Date

The provision is effective for taxable years beginning after December 31, 2013.

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[240] For example, assume that during 2012, a company's only asset purchases are IRC section 179-eligible equipment costing $100,000 and qualifying leasehold improvements costing $200,000. Assume the company has no other asset purchases during 2012, and has a taxable income limitation of $150,000. The maximum IRC section 179 deduction the company can claim for 2012 is $150,000, which is allocated pro rata between the properties, such that the carryover to 2013 is allocated $100,000 to the qualified leasehold improvements and $50,000 to the equipment.
Assume further that in 2013, the company had no asset purchases and had taxable income of $-0-. The $100,000 carryover from 2012 attributable to qualified leasehold improvements is treated as placed in service as of the first day of the company's 2013 taxable year. The $50,000 carryover allocated to equipment is carried over to 2013 under IRC section 179(b)(3)(B).

[241] IRC section 179(c)(1).

[242] IRC section 179(c)(2).

California Law (R&TC sections 17201, 17255, and 24356)

California conforms to the federal election to deduct (or "expense") the cost of qualifying property under IRC section 179, rather than to recover such costs through depreciation deductions (herein referred to as "small business expensing"), as of the "specified date" of January 1, 2009,[243] with modifications.

California specifically does not conform to the increased "small business expensing" that was first enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003[244] and then extended and modified in several subsequent federal acts.[245] Thus, under California law, both corporate and non-corporate taxpayers with a sufficiently small amount of annual investment in qualified depreciable property may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The $25,000 and $200,000 amounts are not indexed for inflation.

In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

Impact on California Revenue

Not applicable.

Section	Section Title
128	Extension of Election to Expense Mine Safety Equipment

Background

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the

[243] Under the Personal Income Tax Law, R&TC section 17201(a) conforms to IRC section 179 as of the "specified date" of January 1, 2009, with modifications in R&TC section 17255. Under the Corporation Tax Law, R&TC 24356(b) conforms to IRC section 179 as of the "specified date" of January 1, 2009, with modifications.

[244] Public Law 108-27, Section 202.

[245] Public Law 108-357, Section 201; Public Law 109-222, Section 101; Public Law 110-28, Section 8212; Public Law 111-5, Section 1202; Public Law 111-147, Section 201; Public Law 111-240, Section 2021; and Public Law 111-312, Section 402; Public Law 112-240, Section 315.

depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system (MACRS).[246] Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property (generally tangible property other than residential rental property and nonresidential real property) range from 3 to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the depreciation deduction would be maximized.

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct (or "expense") such costs under IRC section 179. Present law provides that the maximum amount a taxpayer may expense for taxable years beginning in 2010, 2011, 2012, and 2013 is $500,000 of the cost of the qualifying property for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.[247] The $500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000.

A taxpayer may elect to treat 50 percent of the cost of any qualified advanced mine safety equipment property as an expense in the taxable year in which the equipment is placed in service.[248] The deduction under IRC section 179E is allowed for both regular and alternative minimum tax purposes, including adjusted current earnings. In computing earnings and profits, the amount deductible under IRC section 179E is allowed as a deduction ratably over five taxable years beginning with the year the amount is deductible under IRC section 179E.[249]

"Qualified advanced mine safety equipment property" means any advanced mine safety equipment property for use in any underground mine located in the United States the original use of which commences with the taxpayer and which is placed in service before January 1, 2014.[250]

Advanced mine safety equipment property means any of the following: (1) emergency communication technology or devices used to allow a miner to maintain constant communication with an individual who is not in the mine, (2) electronic identification and location devices that allow individuals not in the mine to track at all times the movements and location of miners working in or at the mine, (3) emergency oxygen-generating, self-rescue devices that provide oxygen for at least 90 minutes, (4) pre-positioned supplies of oxygen providing each miner on a shift the ability to survive for at least 48 hours, and (5) comprehensive atmospheric monitoring

[246] IRC section 168.

[247] The definition of qualifying property was temporarily (for 2010, 2011, 2012, 2013, and 2014) expanded to include up to $250,000 of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. See IRC section 179(c) and Section 122 of this Act.

[248] IRC section 179E(a).

[249] IRC section 312(k)(3).

[250] IRC sections 179E(c) and (g).

systems that monitor the levels of carbon monoxide, methane and oxygen that are present in all areas of the mine and that can detect smoke in the case of a fire in a mine.[251]

The portion of the cost of any property with respect to which an expensing election under IRC section 179 is made may not be taken into account for purposes of the 50-percent deduction under IRC section 179E.[252] In addition, a taxpayer making an election under IRC section 179E must file with the Secretary of the Treasury a report containing information with respect to the operation of the mines of the taxpayer as required by the Secretary.[253]

New Federal Law (IRC section 179E)

The provision extends for one year (through December 31, 2014) the present-law placed-in-service date relating to expensing of mine safety equipment.

Effective Date

The provision applies to property placed in service after December 31, 2013.

California Law (R&TC sections 17201, 17255, 17257.4, and 24356)

This provision is not applicable under California law.

Under the Personal Income Tax Law, California specifically does not conform to the federal election to expense advanced mine safety equipment,[254] and the election has not been adopted under the Corporation Tax Law. Under both the Personal Income Tax Law and the Corporation Tax Law, as it relates to the election to deduct (or "expense") costs in lieu of depreciation, California conforms to IRC section 179, with significant modifications.[255]

Taxpayers with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations.).

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[251] IRC section 179E(d).

[252] IRC section 179E(e).

[253] IRC section 179E(f).

[254] R&TC section 17257.4.

[255] R&TC sections 17255 and 24356.

Impact on California Revenue

Not applicable.

Section	Section Title
129	Extension of Special Expensing Rules for Certain Film and Television Productions

Background

The modified accelerated cost recovery system (MACRS) does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years.

IRC section 197, which allows amortization for certain intangible property, does not apply to some intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a “stand-alone” basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the IRC section 197 amortization provisions. The cost recovery of such property may be determined under IRC section 167, that allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property. A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. IRC section 167(g) provides that the cost of motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income-forecast method of depreciation.

Under IRC section 181, taxpayers may elect[256] to deduct the cost of any qualifying film and television production, commencing prior to January 1, 2014, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.[257] Taxpayers may elect to deduct up to $15 million of the aggregate cost of the film or television production under this section.[258] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income

[256] For rules on making an election under this section, see Temp. Treas. Reg. section 1.181–2T.

[257] For this purpose, a production is treated as commencing on the first date of principal photography.

[258] IRC section 181(a)(2)(A).

community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[259]

A qualified film or television production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format) or television program if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[260] The term “compensation” does not include participations and residuals (as defined in IRC section 167(g)(7)(B)).[261] With respect to property which is one or more episodes in a television series, each episode is treated as a separate production and only the first 44 episodes qualify under the provision.[262] Qualified property does not include sexually explicit productions as defined by section 2257 of title 18 of the U.S. Code.[263]

For purposes of recapture under IRC section 1245, any deduction allowed under IRC section 181 is treated as if it were a deduction allowable for amortization.[264]

New Federal Law (IRC section 181)

The provision extends the present-law expensing provision for one year, to qualified film and television productions commencing prior to January 1, 2015.

Effective Date

The provision applies to qualified film and television productions commencing after December 31, 2013.

California Law (R&TC sections 17250, 17201.5, 17250.5, and 24349)

This provision is not applicable under California law.

Under the Personal Income Tax Law, California specifically does not conform to the federal election to deduct the cost of any qualifying film and television production in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances,[265] and the election has not been adopted under the Corporation Tax Law.

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[259] IRC section 181(a)(2)(B).

[260] IRC section 181(d)(3)(A).

[261] IRC section 181(d)(3)(B).

[262] IRC section 181(d)(2)(B).

[263] IRC section 81(d)(2)(C).

[264] IRC section 1245(a)(2)(C).

[265] R&TC section 17201.5.

Under both the Personal Income Tax Law and the Corporation Tax Law, California generally conforms to the federal income-forecast method to determine the depreciation recovery periods of property such as films, videotapes, television, book rights, patents, master sound recordings, video games, and like items.[266]

Impact on California Revenue

Not applicable.

Section	Section Title
130	Extension of Deduction Allowable with Respect to Income Attributable to Domestic Production Activities in Puerto Rico

Background

In General

Present law provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts, and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[267] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States, (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[268] produced by the taxpayer, (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced

[266] R&TC sections 17250.5 and 24349(f) conform to IRC section 167(g), relating to depreciation under the income forecast method, as of the "specified date" of January 1, 2009, with modifications.

[267] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[268] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

by the taxpayer in the United States, (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business, or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[269] Wages paid to bona fide residents of Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.[270]

Rules for Puerto Rico

When used in the IRC in a geographical sense, the term "United States" generally includes only the states and the District of Columbia.[271] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the federal income tax for individuals or corporations.[272] In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[273]

The special rules for Puerto Rico apply only with respect to the first eight taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2014.

<u>New Federal Law (IRC section 199)</u>

The provision extends the special domestic production activities rules for Puerto Rico to apply for the first nine taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2015.

<u>Effective Date</u>

The provision is effective for taxable years beginning after December 31, 2013.

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[269] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in IRC section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

[270] IRC section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

[271] IRC section 7701(a)(9).

[272] IRC section 199(d)(8)(A).

[273] IRC section 199(d)(8)(B).

California Law (R&TC sections 17250 and 17201.6)

This provision is not applicable under California law. Under the Personal Income Tax Law, California specifically does not conform to the deduction for income attributable to domestic production entities, and the deduction has not been adopted under the Corporation Tax Law.

Impact on California Revenue

Not applicable.

Section	Section Title
131	Extension of Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations

Background

In general, organizations exempt from federal income tax are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[274] In general, interest, rents, royalties, and annuities are excluded from the unrelated business income of tax-exempt organizations.[275]

IRC section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary. In general, IRC section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business taxable income if such income is received from a taxable or tax-exempt subsidiary that is 50-percent controlled by the parent tax-exempt organization to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt). However, a special rule provides that, for payments made pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), the general rule of IRC section 512(b)(13) applies only to the portion of payments received or accrued in a taxable year that exceeds the amount of the payment that would have been paid or accrued if the amount of such payment had been determined under the principles of IRC section 482 (i.e., at arm's length).[276] In addition, the special rule imposes a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

[274] IRC section 511.

[275] IRC section 512(b).

[276] IRC section 512(b)(13)(E).

In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, "control" means ownership of more than 50 percent of the profits, capital, or beneficial interests. In addition, present law applies the constructive ownership rules of IRC section 318 for purposes of IRC section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

The special rule does not apply to payments received or accrued after December 31, 2013.

New Federal Law (IRC section 512)

The provision extends the special rule for one year to payments received or accrued before January 1, 2015. Accordingly, under the provision, payments of rent, royalties, annuities, or interest income by a controlled organization to a controlling organization pursuant to a binding written contract in effect on August 17, 2006 (or renewal of such a contract on substantially similar terms), may be includible in the unrelated business taxable income of the controlling organization only to the extent the payment exceeds the amount of the payment determined under the principles of IRC section 482 (i.e., at arm's length). Any such excess is subject to a 20-percent penalty on the larger of such excess determined without regard to any amendment or supplement to a return of tax, or such excess determined with regard to all such amendments and supplements.

Effective Date

The provision is effective for payments received or accrued after December 31, 2013.

California Law (R&TC sections 17651, 23731, 23732, and 23772)

California imposes a tax on the "unrelated business income" of organizations and trusts exempt from tax,[277] and generally conforms to the federal rules that apply to unrelated business taxable income as of the "specified date" of January 1, 2009.[278] However, California law does not conform to the federal special rule for certain amounts received or accrued by exempt organizations from controlled entities. California never conformed to that special rule for payments received or accrued on or before December 31, 2009, and because both this extension and the prior federal extensions (that extended the special rule through 2013)[279] were enacted after the "specified date" of January 1, 2009, California law does not conform to them.

[277] R&TC sections 17561 and 23732.

[278] R&TC section 23732 conforms to IRC section 512, relating to unrelated business taxable income, as of the "specified date" of January 1, 2009, with modifications.

[279] Section 747 of Public Law 111-312 and Section 319 of Public Law 112-240.

Impact on California Revenue

None (this provision expires for payments received or accrued after December 31, 2014).

Section	Section Title
132	Extension of Treatment of Certain Dividends of Regulated Investment Companies

Background

In General

A regulated investment company (RIC) is an entity that meets certain requirements (including a requirement that its income generally be derived from passive investments such as dividends and interest and a requirement that it distribute at least 90 percent of its income) and that elects to be taxed under a special tax regime. Unlike an ordinary corporation, an entity that is taxed as a RIC can deduct amounts paid to its shareholders as dividends. In this manner, tax on RIC income is generally not paid by the RIC but rather by its shareholders. Income of a RIC distributed to shareholders as dividends is generally treated as an ordinary income dividend by those shareholders, unless other special rules apply. Dividends received by foreign persons from a RIC are generally subject to gross-basis tax under IRC sections 871(a) or 881, and the RIC payor of such dividends is obligated to withhold such tax under IRC sections 1441 and 1442.

Under a temporary provision of prior law, a RIC that earned certain interest income that generally would not be subject to U.S. tax if earned by a foreign person directly could, to the extent of such net interest income, designate a dividend it paid as derived from such interest income for purposes of the treatment of a foreign RIC shareholder. A foreign person who is a shareholder in the RIC generally could treat such a dividend as exempt from gross-basis U.S. tax. Also, subject to certain requirements, the RIC was exempt from withholding the gross-basis tax on such dividends. Similar rules applied with respect to the designation of certain short-term capital gain dividends. However, these provisions relating to dividends with respect to interest income and short-term capital gain of the RIC do not apply to dividends with respect to any taxable year of a RIC beginning after December 31, 2013.[280]

New Federal Law (IRC section 871)

The provision extends the rules exempting from gross basis tax and from withholding tax the interest-related dividends and short-term capital gain dividends received from a RIC, to dividends with respect to taxable years of a RIC beginning before January 1, 2015.

[280] IRC sections 871(k), 881(e), 1441(c)(12), and 1441(a).

Effective Date

The provision applies to dividends paid with respect to any taxable year of the RIC beginning after December 31, 2013.

California Law (None)

California does not conform to the federal gross-basis tax.

Impact on California Revenue

Not applicable.

Section	Section Title
133	Extension of RIC Qualified Investment Entity Treatment under FIRPTA

Background

Special U.S. tax rules apply to capital gains of foreign persons that are attributable to dispositions of interests in U.S. real property. In general, although a foreign person (a foreign corporation or a nonresident alien individual) is not generally taxed on U.S. source capital gains unless certain personal presence or active business requirements are met, a foreign person who sells a U.S. real property interest (USRPI) is subject to tax at the same rates as a U.S. person, under the Foreign Investment in Real Property Tax Act (FIRPTA) provisions codified in IRC section 897. Withholding tax is also imposed under IRC section 1445.

A USRPI includes stock or a beneficial interest in any domestic corporation unless such corporation has not been a U.S. real property holding corporation (as defined) during the testing period. A USRPI does not include an interest in a domestically controlled "qualified investment entity." A distribution from a "qualified investment entity" that is attributable to the sale of a USRPI is also subject to tax under FIRPTA unless the distribution is with respect to an interest that is regularly traded on an established securities market located in the United States and the recipient foreign corporation or nonresident alien individual did not hold more than five percent of that class of stock or beneficial interest within the one-year period ending on the date of distribution.[281] Special rules apply to situations involving tiers of qualified investment entities.

[281] IRC sections 857(b)(3)(F), 852(b)(3)(E), and 871(k)(2)(E) require dividend treatment, rather than capital gain treatment, for certain distributions to which FIRPTA does not apply by reason of this exception. See also IRC section 881(e)(2).

The term "qualified investment entity" includes a real estate investment trust (REIT) and also includes a regulated investment company (RIC) that meets certain requirements, although the inclusion of a RIC in that definition does not apply for certain purposes after December 31, 2013.[282]

New Federal Law (IRC section 897)

The provision extends the inclusion of a RIC within the definition of a "qualified investment entity" under IRC section 897 through December 31, 2014, for those situations in which that inclusion would otherwise have expired after December 31, 2013.

Effective Date

The provision is generally effective on January 1, 2014. The provision does not apply with respect to the withholding requirement under IRC section 1445 for any payment made before December 19, 2014, but a RIC that withheld and remitted tax under IRC section 1445 on distributions made after December 31, 2013, and before December 19, 2014, is not liable to the distributee with respect to such withheld and remitted amounts.

California Law (None)

California does not generally conform to the federal rules for sourcing the income for foreign corporations, except for certain foreign corporations doing business in California. Those corporations, which have a water's-edge election in force, are required to use federal sourcing rules, such as those set forth in IRC sections 861 through 865 and Sections 897(g) and (h), as applicable for federal purposes, to determine United States source income, including rules for foreign corporations. In other words, California already conforms to these changes for water's-edge purposes.

Impact on California Revenue

Not applicable.

Section	Section Title
134	Extension of Subpart F Exception for Active Financing Income

Background

Under the subpart F rules,[283] 10-percent-or-greater U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether

[282] IRC section 897(h).

or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, insurance income and foreign base company income. Foreign base company income includes, among other things, foreign personal holding company income and foreign base company services income (i.e., income derived from services performed for or on behalf of a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: (1) dividends, interest, royalties, rents, and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and real estate mortgage investment conduits (REMICs); (3) net gains from commodities transactions; (4) net gains from certain foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; (7) payments in lieu of dividends; and (8) amounts received under personal service contracts.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income.[284]

Temporary exceptions from foreign personal holding company income, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, as a securities dealer, or in the conduct of an insurance business (so-called "active financing income").

With respect to income derived in the active conduct of a banking, financing, or a similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active-financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit (QBU) of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign personal holding company income apply for certain income derived by a securities dealer within the meaning of

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[283] IRC sections 951–964.

[284] Prop. Treas. Reg. section 1.953–1(a).

IRC section 475 and for gain from the sale of active financing assets.

In the case of a securities dealer, the temporary exception from foreign personal holding company income applies to certain income. The income covered by the exception is any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning of IRC section 475. In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that this exception generally takes precedence over the exception for income of a banking, financing or similar business, in the case of a securities dealer.

In the case of insurance, a temporary exception from foreign personal holding company income applies for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. In the case of insurance, temporary exceptions from insurance income and from foreign personal holding company income also apply for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met. In the case of a life insurance or annuity contract, reserves for such contracts are determined under rules specific to the temporary exceptions. Present law also permits a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for federal income tax purposes.

New Federal Law (IRC sections 953 and 954)

The provision extends for one year (for taxable years beginning before January 1, 2015) the temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

California Law (R&TC sections 25110 and 25116)

The Corporation Tax Law does not conform by reference to subpart F rules under IRC sections 951 through 971. However, relating to the water's-edge election, the Corporation Tax Law specifically provides that the amount of a CFC's income and apportionment factors included in California taxable income when the CFC has federal subpart F income is determined by multiplying these items by the ratio, the numerator of which is the CFC's federal subpart F income for the current year, and the denominator of which is the CFC's current year federal earnings and profits, as defined by IRC section 964. Subpart F income, as defined in IRC section 952, includes:

- Insurance income;[285]
- Foreign base company income;[286]
- International boycott income;[287]
- Income from illegal bribes and kickbacks;[288] and
- Foreign country income ineligible for the foreign tax credit.[289]

When applying provisions of the IRC in connection with a water's-edge election that are otherwise not applicable, such as subpart F rules, the federal rules—as applicable for federal purposes—apply.[290] Thus, under California water's-edge rules, the one-year extension of the active-financing-income exception automatically applies.

Impact on California Revenue

Baseline.

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[285] IRC section 953.

[286] IRC section 954.

[287] IRC sections 952(a)(3) and 999.

[288] IRC section 952(a)(4).

[289] IRC sections 901(j) and 952(a)(5).

[290] R&TC section 25116.

Section	Section Title
135	Extension of Look-Thru Treatment of Payments between Related Controlled Foreign Corporations under Foreign Personal Holding Company Rules

Background

In General

The rules of subpart F[291] require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation (CFC) to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States that is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

The "Look-Thru Rule"

Under the "look-thru rule" (IRC section 954(c)(6)), dividends, interest (including factoring income that is treated as equivalent to interest under IRC section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F income nor treated as ECI. For this purpose, a related CFC is a CFC that controls or is controlled by the other CFC, or a CFC that is controlled by the same person or persons that control the other CFC. Ownership of more than 50 percent of the CFC's stock (by vote or value) constitutes control for these purposes.

The Secretary of the Treasury is authorized to prescribe regulations that are necessary or appropriate to carry out the look-thru rule, including such regulations as are necessary or appropriate to prevent the abuse of the purposes of such rule.

[291] IRC sections 951–964.

The look-thru rule is effective for taxable years of foreign corporations beginning before January 1, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

New Federal Law (IRC section 954)

The provision extends for one year the application of the look-thru rule, to taxable years of foreign corporations ending before January 1, 2015, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Effective Date

The provision is effective for taxable years of foreign corporations beginning after December 31, 2013, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

California Law (R&TC sections 25110 and 25116)

The Corporation Tax Law does not conform by reference to subpart F rules under IRC sections 951 through 971. However, relating to the water's-edge election, the Corporation Tax Law specifically provides that the amount of a CFC's income and apportionment factors included in California taxable income when the CFC has federal subpart F income is determined by multiplying these items by the ratio, the numerator of which is the CFC's federal subpart F income for the current year, and the denominator of which is the CFC's current year federal earnings and profits, as defined by IRC section 964. Subpart F income, as defined in IRC section 952, includes:

- Insurance income;[292]
- Foreign base company income;[293]
- International boycott income;[294]
- Income from illegal bribes and kickbacks;[295] and
- Foreign country income ineligible for the foreign tax credit.[296]

When applying provisions of the IRC in connection with a water's-edge election that are otherwise not applicable, such as subpart F rules, the federal rules—as applicable for federal purposes—apply.[297] Thus, under California water's-edge rules, the one-year extension of the look-thru rule automatically applies.

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[292] IRC section 953.

[293] IRC section 954.

[294] IRC sections 952(a)(3) and 999.

[295] IRC section 952(a)(4).

[296] IRC sections 901(j) and 952(a)(5).

[297] R&TC section 25116.

Impact on California Revenue

Baseline.

Section	Section Title
136	Extension of Temporary Exclusion of 100 Percent of Gain on Certain Small Business Stock

Background

In General

A taxpayer other than a corporation may exclude 50 percent (60 percent for certain empowerment zone businesses) of the gain from the sale of certain small business stock acquired at original issue and held for at least five years.[298] The amount of gain eligible for the exclusion by an eligible taxpayer with respect to the stock of any qualifying domestic C corporation is the greater of: (1) ten times the taxpayer's basis in the stock, or (2) $10 million (reduced by the amount of gain eligible for exclusion in prior years). To qualify as a qualified small business, when the stock is issued, the aggregate gross assets (i.e., cash plus aggregate adjusted basis of other property) held by the domestic C corporation may not exceed $50 million. The corporation also must meet certain active trade or business requirements.

The portion of the gain includible in taxable income is taxed at a maximum rate of 28 percent under the regular tax.[299] A percentage of the excluded gain is an alternative minimum tax preference;[300] the portion of the gain includible in alternative minimum taxable income is taxed at a maximum rate of seven percent under the alternative minimum tax.

[298] IRC section 1202.

[299] IRC section 1(h).

[300] IRC section 57(a)(7).

Special Rules for Certain Qualified Small Business Stock Acquired in 2009, 2010, 2011, 2012, and 2013

For qualified small business stock acquired after February 17, 2009, and before September 28, 2010, the percentage exclusion is increased to 75 percent.

As a result of the increased exclusion, gain from the sale of qualified small business stock to which the provision applies is taxed at maximum effective rates of seven percent under the regular tax[301] and 12.88 percent under the AMT.[302]

For qualified small business stock acquired after September 27, 2010, and before January 1, 2014, the percentage exclusion is increased to 100 percent and the minimum tax preference does not apply.

Rollover of Gain

A taxpayer other than a corporation may elect to rollover gain from the sale of qualified small business stock held more than six months where other qualified small business stock is purchased during the 60-day period beginning on the date of sale.[303] The holding period for the replacement stock includes the period the original stock was held.

New Federal Law (IRC section 1202)

The provision extends the 100-percent exclusion and the exception from minimum tax preference treatment for one year (for stock acquired before January 1, 2015).[304]

Effective Date

The provision is generally effective for stock acquired after December 31, 2013. The clarification applies to stock acquired after February 17, 2009.

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[301] The 25 percent of gain included in taxable income is taxed at a maximum rate of 28 percent.

[302] The 46 percent of gain included in AMTI is taxed at a maximum rate of 28 percent. Forty-six percent is the sum of 25 percent (the percentage of total gain included in taxable income) plus 21 percent (the percentage of total gain which is an alternative minimum tax preference).

[303] IRC section 1045.

[304] Section 102 of the American Taxpayer Relief Act of 2012 (Public Law 112-240) made permanent the seven-percent minimum tax preference amount for qualified small business stock acquired before September 28, 2010.

California Law (R&TC sections 17062, 18038.5, 18152, and 18152.5)

California Qualified Small Business Stock Provisions - Deemed Unconstitutional

Overview of California Small Business Stock Provisions – Prior to Being Found Unconstitutional

The Personal Income Tax Law specifically did not conform to the federal exclusion for gain on qualified small business stock,[305] and instead had its own exclusion that provided that noncorporate taxpayers could exclude from gross income 50 percent of gain from the sale or exchange of California qualified small business stock acquired at original issue and held for more than five years.[306] The amount of gain eligible for the exclusion with respect to any corporation was the greater of: (1) ten times the taxpayer's basis in the stock; or (2) $10 million. California qualified small business stock generally meant stock in a C corporation[307] that: (1) had gross assets that did not exceed $50 million; (2) had at least 80 percent of its payroll attributable to employment located in California; and (3) used at least 80 percent of the value of its assets in the active conduct of one or more qualified trades or businesses in California.

Deemed Unconstitutional by the Second District Court of Appeal – August 28, 2012

In the superior court case of *Cutler v. Franchise Tax Board,*[308] a taxpayer raised the issue of the constitutionality of California's qualified small business stock provisions (R&TC sections 18152.5 and 18038.5). The superior court upheld the constitutionality of these statutes. However, on appeal, the Second District Court of Appeal reversed the trial court's determination and held that because the purpose and effect of California's qualified small business stock statutes is to favor California corporations—those with property and payroll primarily within California—over their foreign competitors in raising capital among California residents, the statutes are discriminatory and cannot stand under the commerce clause of the U.S. Constitution.[309]

As a result, the FTB determined that because the Court of Appeal held that R&TC sections 18152.5 and 18038.5 are unconstitutional, these sections became invalid and unenforceable.[310]

[305] R&TC section 18152.

[306] R&TC section 18152.5. The California exclusion under R&TC section 18152.5 generally paralleled the federal exclusion under IRC section 1202, with modifications. Additionally, prior to being deemed unconstitutional, R&TC section 18038.5 generally paralleled the federal rules for the rollover of gain of qualified small business stock under IRC section 1045 by providing that noncorporate taxpayers could defer the gain from the sale of California qualified small business stock held more than six months where other California qualified small business stock (replacement stock) was purchased within the 60-day period beginning on the date of the sale.

[307] The stock must be that of a domestic C corporation that is not a DISC or former DISC, a regulated investment company, a real estate investment trust, a real estate mortgage investment conduit, or a cooperative.

[308] Super. Ct. L. A. County, 2012, No. BC421864.

[309] *Cutler v. Franchise Tax Board* (2012) 208 Cal. App. 4th 1247.

[310] See FTB Notice 2012-03 at: https://www.ftb.ca.gov/law/notices/2012/2012_03.pdf.

2013 Legislation Allows a Limited, Modified California Qualified Small Business Stock Exclusion

AB 1412 (Chapter 546 of the Statutes of 2013) provides a limited, modified California qualified small business stock exclusion by allowing taxpayers to exclude 50 percent of the gain from the sale or exchange of their California qualified small business stock for taxable years beginning on or after January 1, 2008, and before January 1, 2013. In addition, taxpayers are allowed to exclude 50 percent of the gain included in installment payments received, or that will be received, in taxable years beginning on or after January 1, 2008, for sales of California qualified small business stock made in taxable years beginning before January 1, 2013.

For purposes of this limited, modified exclusion, the definition of qualified small business means a domestic C corporation that meets the following:

- The aggregate gross assets of the corporation (or its predecessor) at all times on or after July 1, 1993, and before the issuance of the stock, did not exceed $50 million;
- The aggregate gross assets of the corporation immediately after the issuance did not exceed $50 million; and
- At least 80 percent of the corporation's payroll is attributable to employment located within California (at time of stock issuance).

Impact on California Revenue

Not applicable.

Section	Section Title
137	Extension of Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property

Background

Under present law, if an S corporation contributes money or other property to a charity, each shareholder takes into account the shareholder's pro-rata share of the contribution in determining its own income tax liability.[311] A shareholder of an S corporation reduces the basis in the stock of the S corporation by the amount of the charitable contribution that flows through to the shareholder.[312]

In the case of charitable contributions made in taxable years beginning before January 1, 2014, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation is equal to the shareholder's pro-rata share of the

[311] IRC section 1366(a)(1)(A).

[312] IRC section 1367(a)(2)(B).

adjusted basis of the contributed property. For contributions made in taxable years beginning after December 31, 2013, the amount of the reduction is the shareholder's pro-rata share of the fair market value of the contributed property.

New Federal Law (IRC section 1367)

The provision extends the rule relating to the basis reduction on account of charitable contributions of property for one year to contributions made in taxable years beginning before January 1, 2015.

Effective Date

The provision applies to charitable contributions made in taxable years beginning after December 31, 2013.

California Law (R&TC sections 17087.5, 23800, and 23804)

The Personal Income Tax Law and the Corporation Tax Law generally conform to the federal rules relating to the tax treatment of S corporations and their shareholders as of the "specified date" of January 1, 2009.[313] As a result, the Personal Income Tax Law and the Corporation Tax Law do not conform to the temporary federal pro-rata-share-of-adjusted-basis reduction rule for contributions made by S corporations. Under California law, if an S corporation contributes money or other property to a charity, the amount of the shareholder's California basis reduction in the stock of the S corporation is the shareholder's pro-rata share of the fair market value of the contributed property.

Impact on California Revenue

None (this provision expires for contributions made in taxable years beginning after December 31, 2014).

Section	Section Title
138	Extension of Reduction in S-Corporation Recognition Period for Built-in Gains Tax

Background

In General

A "small business corporation" (as defined in IRC section 1361(b)) may elect to be treated as an

[313] R&TC sections 17087.5 and 23800 conform to IRC section 1367, relating to the tax treatment of S corporations and their shareholders, as of the "specified date" of January 1, 2009, with modifications.

S corporation. Unlike C corporations, S corporations generally pay no corporate-level tax. Instead, items of income and loss of an S corporation pass through to its shareholders. Each shareholder takes into account separately its share of these items on its own income tax return.[314]

Under IRC section 1374, a corporate level built-in gains tax, at the highest marginal rate applicable to corporations (currently 35 percent), is imposed on an S corporation's net recognized built-in gain[315] that arose prior to the conversion of the C corporation to an S corporation and is recognized by the S corporation during the recognition period, i.e., the 10-year period beginning with the first day of the first taxable year for which the S election is in effect.[316] If the taxable income of the S corporation is less than the amount of net recognized built-in gain in the year such built-in gain is recognized (for example, because of post-conversion losses), no tax under IRC section 1374 is imposed on the excess of such built-in gain over taxable income for that year. However the untaxed excess of net recognized built-in gain over taxable income for that year is treated as recognized built-in gain in the succeeding taxable year.[317] Treasury regulations provide that if a corporation sells an asset before or during the recognition period and reports the income from the sale using the installment method under IRC section 453 during or after the recognition period, that income is subject to tax under IRC section 1374.[318]

The built-in gains tax also applies to net recognized built-in gain attributable to any asset received by an S corporation from a C corporation in a transaction in which the S corporation's basis in the asset is determined (in whole or in part) by reference to the basis of such asset (or other property) in the hands of the C corporation.[319] In the case of such a transaction, the recognition period for any asset transferred by the C corporation starts on the date the asset was acquired by the S corporation in lieu of the beginning of the first taxable year for which the corporation was an S corporation.[320]

The amount of the built-in gains tax under IRC section 1374 is treated as a loss by each of the S corporation shareholders in computing its own income tax.[321]

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[314] IRC section 1366.

[315] Certain built-in income items are treated as recognized built-in gain for this purpose. IRC section 1374(d)(5).

[316] IRC section 1374(d)(7)(A). The 10-year period refers to ten calendar years from the first day of the first taxable year for which the corporation was an S corporation. Treas. Reg. section 1.1374–1(d). A regulated investment company (RIC) or a real estate investment trust (REIT) that was formerly a C corporation (or that acquired assets from a C corporation) generally is subject to the rules of IRC section 1374 as if the RIC or REIT were an S corporation, unless the relevant C corporation elects "deemed sale" treatment. Treas. Reg. sections 1.337(d)–7(b)(1) and (c)(1).

[317] IRC section 1374(d)(2).

[318] Treas. Reg. section 1.1374–4(h).

[319] IRC section 1374(d)(8).

[320] IRC section 1374(d)(8)(B).

[321] IRC section 1366(f)(2). Shareholders continue to take into account all items of gain and loss under IRC section 1366.

Special Rules for 2009, 2010, 2011, 2012, and 2013

For any taxable year beginning in 2009 and 2010, no tax was imposed on the net recognized built-in gain of an S corporation under IRC section 1374 if the seventh taxable year in the corporation's recognition period preceded such taxable year.[322] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under IRC section 1374 if the seventh taxable year that the S corporation election was in effect preceded the taxable year beginning in 2009 or 2010.

For any taxable year beginning in 2011, 2012, and 2013, no tax was imposed on the net recognized built-in gain of an S corporation under IRC section 1374 if the fifth year in the corporation's recognition period preceded such taxable year.[323] Thus, with respect to gain that arose prior to the conversion of a C corporation to an S corporation, no tax was imposed under IRC section 1374 if the S corporation election was in effect for five years preceding the taxable year beginning in 2013.

<u>New Federal Law (IRC section 1374)</u>

For taxable years beginning in 2014, the provision applies the term "recognition period" in IRC section 1374, for purposes of determining the net recognized built-in gain, by substituting a five-year period[324] for the otherwise applicable 10-year period. Thus, for such taxable years, the recognition period is the five-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning with the date of acquisition of assets if the rules applicable to assets acquired from a C corporation apply). If an S corporation with assets subject to IRC section 1374 disposes of such assets in a taxable year beginning in 2014 and the disposition occurs more than five years after the first day of the relevant recognition period, gain or loss on the disposition will not be taken into account in determining the net recognized built-in gain.

<u>Effective Date</u>

This provision applies to taxable years beginning after December 31, 2013.

<u>California Law (R&TC sections 17087.5, 23800, and 23809)</u>

California conforms by reference to IRC section 1374, relating to tax imposed on certain built-in gains, as of the "specified date" of January 1, 2009, with modifications.[325] The federal special

[322] IRC section 1374(d)(7)(B).

[323] IRC section 1374(d)(7)(C).

[324] The five-year period refers to five calendar years from the first day of the first taxable year for which the corporation was an S corporation.

[325] R&TC sections 17024.5 and 23051.5.

rules that temporarily reduce the recognition period for the built-in gains tax[326] and the subsequent extensions and modification of those rules[327] were enacted after the "specified date;" thus, California does not conform to them. Under California law, the recognition period for the built-in gains tax is 10 years.

Impact on California Revenue

None (this provision expires for taxable years beginning after 2014).

Section	Section Title
139	Extension of Empowerment Zone Tax Incentives

Background

The Omnibus Budget Reconciliation Act of 1993 (OBRA 93)[328] authorized the designation of nine empowerment zones ("Round I empowerment zones") to provide tax incentives for businesses to locate within certain targeted areas[329] designated by the Secretaries of the Department of Housing and Urban Development (HUD) and the U.S Department of Agriculture (USDA). The Taxpayer Relief Act of 1997[330] authorized the designation of two additional Round I urban empowerment zones, and 20 additional empowerment zones ("Round II empowerment zones"). The Community Renewal Tax Relief Act of 2000 ("2000 Community Renewal Act")[331] authorized a total of ten new empowerment zones ("Round III empowerment zones"), bringing the total number of authorized empowerment zones to 40.[332] In addition, the 2000 Community Renewal Act conformed the tax incentives that are available to businesses in the Round I, Round II, and

[326] Section 1251 of Public Law 111-5, February 17, 2009.

[327] Section 2014 of Public Law 111-240, September 27, 2010, and Section 326 of Public Law 112-240, January 2, 2013.

[328] Public Law 103-66.

[329] The targeted areas are those that have pervasive poverty, high unemployment, and general economic distress, and that satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations.

[330] Public Law 105-34.

[331] Public Law 106-554.

[332] The urban part of the program is administered by HUD and the rural part of the program is administered by the USDA. The eight Round I urban empowerment zones are Atlanta, GA; Baltimore, MD, Chicago, IL; Cleveland, OH; Detroit, MI; Los Angeles, CA; New York, NY; and Philadelphia, PA/Camden, NJ. Atlanta relinquished its empowerment zone designation in Round III. The three Round I rural empowerment zones are Kentucky Highlands, KY; Mid-Delta, MI; and Rio Grande Valley, TX. The 15 Round II urban empowerment zones are Boston, MA; Cincinnati, OH; Columbia, SC; Columbus, OH; Cumberland County, NJ; El Paso, TX; Gary/Hammond/East Chicago, IN; Ironton, OH/Huntington, WV; Knoxville, TN; Miami/Dade County, FL; Minneapolis, MN; New Haven, CT; Norfolk/Portsmouth, VA; Santa Ana, CA; and St. Louis, Missouri/East St. Louis, IL. The five Round II rural empowerment zones are Desert Communities, CA; Griggs-Steele, ND; Oglala Sioux Tribe, SD; Southernmost Illinois Delta, IL; and Southwest Georgia United, GA. The eight Round III urban empowerment zones are Fresno, CA; Jacksonville, FL; Oklahoma City, OK; Pulaski County, AR;

Round III empowerment zones, and extended the empowerment zone incentives through December 31, 2009.[333] The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the empowerment zone incentives through December 31, 2011.[334] The American Taxpayer Relief Act of 2012 extended the empowerment zone incentives through December 31, 2013.[335]

The tax incentives available within the designated empowerment zones include a federal income tax credit for employers who hire qualifying employees, accelerated depreciation deductions on qualifying equipment, tax-exempt bond financing, deferral of capital gains tax on sale of qualified assets sold and replaced, and partial exclusion of capital gains tax on certain sales of qualified small business stock.

The following is a description of the tax incentives.

Wage Credit

A 20-percent wage credit is available to employers for the first $15,000 of qualified wages paid to each employee (i.e., a maximum credit of $3,000 with respect to each qualified employee) who: (1) is a resident of the empowerment zone, and (2) performs substantially all employment services within the empowerment zone in a trade or business of the employer.[336]

The wage credit rate applies to qualifying wages paid before January 1, 2014. Wages paid to a qualified employee who earns more than $15,000 are eligible for the wage credit (although only the first $15,000 of wages is eligible for the credit). The wage credit is available with respect to a qualified full-time or part-time employee (employed for at least 90 days), regardless of the number of other employees who work for the employer. In general, any taxable business carrying out activities in the empowerment zone may claim the wage credit, regardless of whether the employer meets the definition of an "enterprise zone business."[337]

San Antonio, TX; Syracuse, NY; Tucson, AZ; and Yonkers, NY. The two Round III rural empowerment zones are Aroostook County, ME; and Futuro, TX.

[333] If an empowerment zone designation were terminated prior to December 31, 2009, the tax incentives would cease to be available as of the termination date.

[334] Public Law 111-312.

[335] Public Law 112-240.

[336] IRC section 1396. The $15,000 limit is annual, not cumulative such that the limit is the first $15,000 of wages paid in a calendar year which ends with or within the taxable year.

[337] IRC sections 1397C(b) and 1397C(c). However, the wage credit is not available for wages paid in connection with certain business activities described in IRC section 144(c)(6)(B), including a golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack, or liquor store, or certain farming activities. In addition, wages are not eligible for the wage credit if paid to: (1) a person who owns more than five percent of the stock (or capital or profits interests) of the employer, (2) certain relatives of the employer, or (3) if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business.

An employer's deduction otherwise allowed for wages paid is reduced by the amount of wage credit claimed for that taxable year.[338] Wages are not to be taken into account for purposes of the wage credit if taken into account in determining the employer's work opportunity tax credit under IRC section 51 or the welfare-to-work credit under IRC section 51A.[339] In addition, the $15,000 cap is reduced by any wages taken into account in computing the work opportunity tax credit or the welfare-to-work credit.[340] The wage credit may be used to offset up to 25 percent of alternative minimum tax liability.[341]

Increased IRC Section 179 Expensing Limitation

An enterprise zone business is allowed an additional $35,000 of IRC section 179 expensing (for a total of up to $535,000 in 2010, 2011, 2012, and 2013) for qualified zone property placed in service before January 1, 2014.[342] The IRC section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified zone property placed in service during the year by the taxpayer exceeds $2,000,000.[343] The term "qualified zone property" is defined as depreciable tangible property (including buildings) provided that (i) the property is acquired by the taxpayer (from an unrelated party) after the designation took effect, (ii) the original use of the property in an empowerment zone commences with the taxpayer, and (iii) substantially all of the use of the property is in an empowerment zone in the active conduct of a trade or business by the taxpayer. Special rules are provided in the case of property that is substantially renovated by the taxpayer.

An enterprise zone business means any qualified business entity and any qualified proprietorship. A qualified business entity means, any corporation or partnership if for such year: (1) every trade or business of such entity is the active conduct of a qualified business within an empowerment zone; (2) at least 50 percent of the total gross income of such entity is derived from the active conduct of such business; (3) a substantial portion of the use of the tangible property of such entity (whether owned or leased) is within an empowerment zone; (4) a substantial portion of the intangible property of such entity is used in the active conduct of any such business; (5) a substantial portion of the services performed for such entity by its employees are performed in an empowerment zone; (6) at least 35 percent of its employees are residents of an empowerment zone; (7) less than five percent of the average of the aggregate unadjusted bases of the property of such entity is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (8) less than five percent of the

[338] IRC section 280C(a).

[339] IRC sections 1396(c)(3)(A) and 51A(d)(2).

[340] IRC sections 1396(c)(3)(B) and 51A(d)(2).

[341] IRC section 38(c)(2).

[342] IRC sections 1397A and 1397D.

[343] IRC sections 1397A(a)(2) and 179(b)(2). For 2012, the limit is $500,000. For taxable years beginning after 2012, the limit is $200,000.

average of the aggregate unadjusted bases of the property of such entity is attributable to nonqualified financial property.[344]

A qualified proprietorship is any qualified business carried on by an individual as a proprietorship if for such year: (1) at least 50 percent of the total gross income of such individual from such business is derived from the active conduct of such business in an empowerment zone; (2) a substantial portion of the use of the tangible property of such individual in such business (whether owned or leased) is within an empowerment zone; (3) a substantial portion of the intangible property of such business is used in the active conduct of such business; (4) a substantial portion of the services performed for such individual in such business by employees of such business are performed in an empowerment zone; (5) at least 35 percent of such employees are residents of an empowerment zone; (6) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to collectibles other than collectibles that are held primarily for sale to customers in the ordinary course of such business; and (7) less than five percent of the average of the aggregate unadjusted bases of the property of such individual which is used in such business is attributable to nonqualified financial property.[345]

A qualified business is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license or any business prohibited in connection with the employment credit.[346] In addition, the leasing of real property that is located within the empowerment zone is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property is not a qualified business unless at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone.

Expanded Tax-Exempt Financing for Certain Zone Facilities

States or local governments can issue enterprise zone facility bonds to raise funds to provide an enterprise zone business with qualified zone property.[347] These bonds can be used in areas designated enterprise communities as well as areas designated empowerment zones. To qualify, 95 percent (or more) of the net proceeds from the bond issue must be used to finance: (1) qualified zone property whose principal user is an enterprise zone business, and (2) certain land functionally related and subordinate to such property.

The term enterprise zone business is the same as that used for purposes of the increased IRC section 179 deduction limitation (discussed above) with certain modifications for start-up

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[344] IRC section 1397C(b).

[345] IRC section 1397C(c).

[346] IRC section 1397C(d). Excluded businesses include any private or commercial golf course, country club, massage parlor, hot tub facility, sun tan facility, racetrack, or other facility used for gambling or any store the principal business of which is the sale of alcoholic beverages for off-premises consumption. IRC section 144(c)(6).

[347] IRC section 1394.

businesses. First, a business will be treated as an enterprise zone business during a start-up period if: (1) at the beginning of the period, it is reasonable to expect the business to be an enterprise zone business by the end of the start-up period, and (2) the business makes bona fide efforts to be an enterprise zone business. The start-up period is the period that ends with the start of the first tax year beginning more than two years after the later of: (1) the issue date of the bond issue financing the qualified zone property, and (2) the date this property is first placed in service (or, if earlier, the date that is three years after the issue date).[348]

Second, a business that qualifies as an enterprise zone business at the end of the start-up period must continue to qualify during a testing period that ends three tax years after the start-up period ends. After the three-year testing period, a business will continue to be treated as an enterprise zone business as long as 35 percent of its employees are residents of an empowerment zone or enterprise community.

The face amount of the bonds may not exceed $60 million for an empowerment zone in a rural area, $130 million for an empowerment zone in an urban area with zone population of less than 100,000, and $230 million for an empowerment zone in an urban area with zone population of at least 100,000.

Elective Roll Over of Capital Gain from the Sale or Exchange of any Qualified Empowerment Zone Asset

Taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset[349] held for more than one year and replaced within 60 days by another qualified empowerment zone asset in the same zone.[350] The deferral is accomplished by reducing the basis of the replacement asset by the amount of the gain recognized on the sale of the asset.

Partial Exclusion of Capital Gains on Certain Small Business Stock

Generally, individuals may exclude a percentage of gain from the sale of certain small business stock acquired at original issue and held at least five years.[351] For stock acquired prior to

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[348] IRC section 1394(b)(3).

[349] The term “qualified empowerment zone asset” means any property which would be a qualified community asset (as defined in IRC section 1400F, relating to certain tax benefits for renewal communities) if in IRC section 1400F: (i) references to empowerment zones were substituted for references to renewal communities, (ii) references to enterprise zone businesses (as defined in IRC section 1397C) were substituted for references to renewal community businesses, and (iii) the date of the enactment of this paragraph were substituted for “December 31, 2001” each place it appears. IRC section 1397B(b)(1)(A).

A “qualified community asset” includes: (1) qualified community stock (meaning original-issue stock purchased for cash in an enterprise zone business), (2) a qualified community partnership interest (meaning a partnership interest acquired for cash in an enterprise zone business), and (3) qualified community business property (meaning tangible property originally used in an enterprise zone business by the taxpayer) that is purchased or substantially improved after the date of the enactment of this paragraph.

[350] IRC section 1397B.

[351] IRC section 1202.

February 18, 2009, or after December 31, 2011, the percentage is generally 50 percent, except that for empowerment zone stock the percentage is 60 percent. For stock acquired after February 17, 2009, and before January 1, 2014, a higher percentage applies to all small business stock with no additional percentage for empowerment zone stock.[352]

Other Tax Incentives

Other incentives not specific to empowerment zones but beneficial to these areas include the work opportunity tax credit for employers based on the first year of employment of certain targeted groups, including empowerment zone residents (up to $2,400 per employee), and qualified zone academy bonds for certain public schools located in an empowerment zone, or expected (as of the date of bond issuance) to have at least 35 percent of its students receiving free or reduced lunches.

New Federal Law (IRC section 1391)

The provision extends for one year, through December 31, 2014, the period for which the designation of an empowerment zone is in effect, thus extending for one year the empowerment zone tax incentives, including the wage credit, increased IRC section 179 expensing for qualifying equipment, tax-exempt bond financing, and deferral of capital gains tax on sale of qualified assets replaced with other qualified assets. In the case of a designation of an empowerment zone the nomination for which included a termination date which such designation if the entity which made such nomination amends the nomination to provide for a new termination date in such manner as the Secretary of the Treasury may provide.

Effective Date

The provision relating to the designation of an empowerment zone is effective for periods after December 31, 2013.

California Law (R&TC sections 17053.33, 17053.45, 17053.46, 17053.47, 17053.70, 17053.74, 17053.75, 23612.2, 23622.7, 23622.8, 23644 and 23646)

Empowerment Zones

California does not conform to the federal empowerment-zone tax incentives. Thus, the one-year federal extension of empowerment zone designations is not applicable under California law.

Prior to 2014, California provided its own tax incentives for taxpayers conducting business activities within geographically targeted economic development areas (EDAs), including Enterprise Zones,[353] Manufacturing Enhancement Areas,[354] Targeted Tax Areas,[355] and Local Agency Military

[352] Section 136 of the Act extends the higher percentage for one year (for stock acquired before January 1, 2015). For a more detailed description of the present-law exclusion, see the explanation in this report to that section of the Act.

[353] R&TC sections 17053.70, 17053.74, 17053.75, 23612.2, and 233622.7.

Base Recovery Areas.[356] The California EDA hiring credits generally cease to be operative for taxable years beginning on or after January 1, 2014; however, the credits continue to apply for taxable years beginning on or after January 1, 2014, with respect to qualified employees who are employed by qualified taxpayers within the 60-month period immediately preceding that date.[357]

Impact on California Revenue

Not applicable.

Section	Section Title
140	Extension of Temporary Increase in Limit on Cover over of Rum Excise Taxes to Puerto Rico and the Virgin Islands

Background

A $13.50 per proof gallon[358] excise tax is imposed on distilled spirits produced in or imported into the United States.[359] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[360]

The IRC provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[361] The amount of the cover over is limited under IRC section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon before January 1, 2014).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are

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354 R&TC sections 17053.47 and 23622.8.

355 R&TC sections 17053.33, 23633 and 23644.

356 R&TC sections 17053.45, 17053.46, 23644 and 23646.

357 See Chapter 69 of the Statutes of 2013.

358 A proof gallon is a liquid gallon consisting of 50 percent alcohol. See IRC section 5002(a)(10) and (11).

359 IRC section 5001(a)(1).

360 IRC sections 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).

361 IRC sections 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under IRC section 7652(b)(3).

divided and covered over to the two possessions under a formula.[362] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[363] All of the amounts covered over are subject to the limitation.

New Federal Law (IRC section 7652)

The provision suspends for one year the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover over limitation of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2013, and before January 1, 2015. After December 31, 2014, the cover over amount reverts to $10.50 per proof gallon.

Effective Date

The provision is effective for distilled spirits brought into the United States after December 31, 2013.

California Law

The FTB does not administer these types of excise taxes. Defer to the Board of Equalization (BOE).

Impact on California Revenue

Defer to the BOE.

Section	Section Title
141	Modification and Extension of American Samoa Economic Development Credit

Background

A domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of IRC section 936 for its last taxable year beginning before January 1, 2006, is allowed a credit based on the corporation's economic activity-based limitation with respect to American Samoa. The credit is not part of the IRC but is computed based on the rules of IRC sections 30A and 936. The credit is allowed for the first four taxable years of a corporation that begin after December 31, 2005, and before January 1, 2014.

[362] IRC section 7652(e)(2).

[363] IRC sections 7652(a)(3), (b)(3), and (e)(1).

A corporation was an existing credit claimant with respect to a American Samoa if: (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on October 13, 1995, and (2) the corporation elected the benefits of the possession tax credit[364] in an election in effect for its taxable year that included October 13, 1995.[365] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of: (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses, and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

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[364] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. IRC sections 27(b) and 936. This credit offsets the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, discussed below, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from: (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under IRC section 936.

Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of: (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. IRC section 936(a)(2). The IRC section 936 credit generally expired for taxable years beginning after December 31, 2005.

[365] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that: (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

The IRC section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under IRC section 936 does not apply with respect to the credit allowed by the provision.

The credit applies to the first four taxable years of a taxpayer which begin after December 31, 2005, and before January 1, 2014.

New Federal Law (Uncodified Act Section 330 Affecting IRC section 30A)

The provision extends the credit to apply to taxable years beginning before January 1, 2015.

Effective Date

The provision is effective for taxable years beginning after December 31, 2013.

California Law (None)

California does not conform to the American Samoa Economic Development Credit.

Impact on California Revenue

Not applicable.

Section	Section Title
151	Extension of Credit for Nonbusiness Energy Property

Background

Present law[366] provides a 10-percent credit for the purchase of qualified energy efficiency improvements to existing homes. A qualified energy efficiency improvement is any energy efficiency building envelope component that: (1) meets or exceeds the prescriptive criteria for such a component established by the 2009 International Energy Conservation Code as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009 (February 17, 2009) (or, in the case of windows, skylights and doors, and metal roofs with appropriate pigmented coatings or asphalt roofs with appropriate cooling granules, meets the Energy Star program requirements); (2) is installed in or on a dwelling located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; (3) the original use of which commences with the taxpayer; and (4) reasonably can be expected to remain in use for at least five years. The credit is nonrefundable.

[366] IRC section 25C.

Building envelope components are: (1) insulation materials or systems which are specifically and primarily designed to reduce the heat loss or gain for a dwelling and which meet the prescriptive criteria for such material or system established by the 2009 International Energy Conservation Code, as such Code (including supplements) is in effect on the date of the enactment of the American Recovery and Reinvestment Tax Act of 2009 (February 17, 2009); (2) exterior windows (including skylights) and doors; and (3) metal or asphalt roofs with appropriate pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain for a dwelling.

Additionally, present law provides specified credits for the purchase of specific energy efficient property originally placed in service by the taxpayer during the taxable year. The allowable credit for the purchase of certain property is: (1) $50 for each advanced main air circulating fan, (2) $150 for each qualified natural gas, propane, or oil furnace or hot water boiler, and (3) $300 for each item of energy efficient building property.

An advanced main air circulating fan is a fan used in a natural gas, propane, or oil furnace and which has an annual electricity use of no more than two percent of the total annual energy use of the furnace (as determined in the standard Department of Energy test procedures).

A qualified natural gas, propane, or oil furnace or hot water boiler is a natural gas, propane, or oil furnace or hot water boiler with an annual fuel utilization efficiency rate of at least 95.

Energy-efficient building property is: (1) an electric heat pump water heater which yields an energy factor of at least 2.0 in the standard Department of Energy test procedure, (2) an electric heat pump which achieves the highest efficiency tier established by the Consortium for Energy Efficiency, as in effect on January 1, 2009,[367] (3) a central air conditioner which achieves the highest efficiency tier established by the Consortium for Energy Efficiency as in effect on January 1, 2009,[368] (4) a natural gas, propane, or oil water heater which has an energy factor of at least 0.82 or thermal efficiency of at least 90 percent, and (5) biomass fuel property.

Biomass fuel property is a stove that burns biomass fuel to heat a dwelling unit located in the United States and used as a principal residence by the taxpayer, or to heat water for such dwelling unit, and that has a thermal efficiency rating of at least 75 percent. Biomass fuel is any plant-derived fuel available on a renewable or recurring basis, including agricultural crops and trees, wood and wood waste and residues (including wood pellets), plants (including aquatic plants), grasses, residues, and fibers.

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[367] These standards are a seasonal energy efficiency ratio (SEER) greater than or equal to 15, an energy efficiency ratio (EER) greater than or equal to 12.5, and heating seasonal performance factor (HSPF) greater than or equal to 8.5 for split heat pumps, and SEER greater than or equal to 14, EER greater than or equal to 12, and HSPF greater than or equal to 8.0 for packaged heat pumps.

[368] These standards are a SEER greater than or equal to 16 and EER greater than or equal to 13 for split systems, and SEER greater than or equal to 14 and EER greater than or equal to 12 for packaged systems.

The credit is available for property placed in service prior to January 1, 2014. The maximum credit for a taxpayer for all taxable years is $500, and no more than $200 of such credit may be attributable to expenditures on windows.

The taxpayer's basis in the property is reduced by the amount of the credit. Special proration rules apply in the case of jointly-owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

For purposes of determining the amount of expenditures made by any individual with respect to any dwelling unit, expenditures which are made from subsidized energy financing are not taken into account. The term "subsidized energy financing" means financing provided under a federal, state, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

New Federal Law (IRC section 25C)

The provision extends the credit for one year, through December 31, 2014.

Effective Date

The provision applies to property placed in service after December 31, 2013.

California Law (None)

California does not conform to the credit for energy-efficient existing homes (i.e., the nonbusiness energy property credit under IRC section 25C).

Impact on California Revenue

Not applicable.

Section	Section Title
152	Extension of Second Generation Biofuel Producer Credit

Background

The "second generation biofuel producer credit" is a nonrefundable income tax credit for each gallon of qualified second generation biofuel production of the producer for the taxable year. The amount of the credit is generally $1.01 per gallon.[369]

"Second generation biofuel production" is any second generation biofuel which is produced by the taxpayer and which is: (1) sold by the taxpayer to another person (a) for use by such other person in the production of a qualified second generation biofuel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or (c) who sells such second generation biofuel at retail to another person and places such second generation biofuel in the fuel tank of such other person; or (2) used by the producer for any purpose described in (1)(a), (b), or (c).

"Second generation biofuel" means any liquid fuel that: (1) is derived by, or from, qualified feedstocks, and (2) meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency (EPA) under section 211 of the Clean Air Act. Second generation biofuel does not include fuels that: (1) are more than four percent (determined by weight) water and sediment in any combination, (2) have an ash content of more than one percent (determined by weight), or (3) have an acid number greater than 25 ("unprocessed or excluded fuels").[370]

"Qualified feedstock" means (1) any lignocellulosic or hemicellulosic matter that is available on a renewable or recurring basis, and (2) any cultivated algae, cyanobacteria, or lemna.

The second generation biofuel producer credit cannot be claimed unless the taxpayer is registered by the Internal Revenue Service (IRS) as a producer of second generation biofuel.

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[369] In the case of cellulosic biofuel that is alcohol, the $1.01 credit amount is reduced by the credit amount of the alcohol mixture credit, and for ethanol, the credit amount for small ethanol producers, as in effect at the time the cellulosic biofuel fuel is produced. The alcohol mixture credit and small ethanol producer credits expired December 31, 2011, so there is no reduction for cellulosic biofuel that is alcohol if produced after December 31, 2011.

[370] IRC section 40(b)(6)(e)(iii). Water content (including both free water and water in solution with dissolved solids) is determined by distillation, using for example ASTM method D95 or a similar method suitable to the specific fuel being tested. Sediment consists of solid particles that are dispersed in the liquid fuel and is determined by centrifuge or extraction using, for example, ASTM method D1796 or D473 or similar method that reports sediment content in weight percent. Ash is the residue remaining after combustion of the sample using a specified method, such as ASTM D3174 or a similar method suitable for the fuel being tested.

New Federal Law (IRC section 40)

The provision extends the income tax credit for second generation biofuel for one additional year (through December 31, 2014).

Effective Date

The provision generally is effective for qualified second generation biofuel production after December 31, 2013.

California Law (None)

California does not conform to the second generation biofuel producer credit.

Impact on California Revenue

Not applicable.

Section	Section Title
153	Extension of Incentives for Biodiesel and Renewable Diesel

Background

Biodiesel

Present law provides an income tax credit for biodiesel fuels (the "biodiesel fuels credit").[371] The biodiesel fuels credit is the sum of three credits: (1) the biodiesel mixture credit, (2) the biodiesel credit, and (3) the small agri-biodiesel producer credit. The biodiesel fuels credit is treated as a general business credit. The amount of the biodiesel fuels credit is includible in gross income. The biodiesel fuels credit is coordinated to take into account benefits from the biodiesel excise tax credit and payment provisions discussed below. The credit does not apply to fuel sold or used after December 31, 2013.

Biodiesel is monoalkyl esters of long-chain fatty acids derived from plant or animal matter that meet: (1) the registration requirements established by the EPA under section 211 of the Clean Air Act (42 U.S.C. section 7545), and (2) the requirements of the American Society of Testing and Materials (ASTM) D6751. Agri-biodiesel is biodiesel derived solely from virgin oils including oils from corn, soybeans, sunflower seeds, cottonseeds, canola, crambe, rapeseeds, safflowers, flaxseeds, rice bran, mustard seeds, camelina, or animal fats.

[371] IRC section 40A.

Biodiesel may be taken into account for purposes of the credit only if the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary of the Treasury) from the producer or importer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.

Biodiesel Mixture Credit

The biodiesel mixture credit is $1.00 for each gallon of biodiesel (including agri-biodiesel) used by the taxpayer in the production of a qualified biodiesel mixture. A qualified biodiesel mixture is a mixture of biodiesel and diesel fuel that is: (1) sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) used as a fuel by the taxpayer producing such mixture. The sale or use must be in the trade or business of the taxpayer and is to be taken into account for the taxable year in which such sale or use occurs. No credit is allowed with respect to any casual off-farm production of a qualified biodiesel mixture.

Per IRS guidance, a mixture need only contain one-tenth of one percent of diesel fuel to be a qualified mixture.[372] Thus, a qualified biodiesel mixture can contain 99.9 percent biodiesel and 0.1 percent diesel fuel.

Biodiesel Credit (B–100)

The biodiesel credit is $1.00 for each gallon of biodiesel that is not in a mixture with diesel fuel (100 percent biodiesel or B–100) and that during the taxable year is: (1) used by the taxpayer as a fuel in a trade or business, or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle.

Small Agri-Biodiesel Producer Credit

The IRC provides a small agri-biodiesel producer income tax credit, in addition to the biodiesel and biodiesel mixture credits. The credit is 10 cents per gallon for up to 15 million gallons of agri-biodiesel produced by small producers, defined generally as persons whose agri-biodiesel production capacity does not exceed 60 million gallons per year. The agri-biodiesel must: (1) be sold by such producer to another person (a) for use by such other person in the production of a qualified biodiesel mixture in such person's trade or business (other than casual off-farm production), (b) for use by such other person as a fuel in a trade or business, or, (c) who sells such agri-biodiesel at retail to another person and places such agri-biodiesel in the fuel tank of such other person, or (2) used by the producer for any purpose described in (a), (b), or (c).

[372] Notice 2005–62, I.R.B. 2005–35, 443 (2005). "A biodiesel mixture is a mixture of biodiesel and diesel fuel containing at least 0.1 percent (by volume) of diesel fuel. Thus, for example, a mixture of 999 gallons of biodiesel and 1 gallon of diesel fuel is a biodiesel mixture."

Biodiesel Mixture Excise Tax Credit

The IRC also provides an excise tax credit for biodiesel mixtures.[373] The credit is $1.00 for each gallon of biodiesel used by the taxpayer in producing a biodiesel mixture for sale or use in a trade or business of the taxpayer. A biodiesel mixture is a mixture of biodiesel and diesel fuel that: (1) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture. No credit is allowed unless the taxpayer obtains a certification (in such form and manner as prescribed by the Secretary of the Treasury) from the producer of the biodiesel that identifies the product produced and the percentage of biodiesel and agri-biodiesel in the product.[374]

The credit is not available for any sale or use for any period after December 31, 2013. This excise tax credit is coordinated with the income tax credit for biodiesel such that credit for the same biodiesel cannot be claimed for both income and excise tax purposes.

Payments With Respect to Biodiesel Fuel Mixtures

If any person produces a biodiesel fuel mixture in such person's trade or business, the Secretary of the Treasury is to pay such person an amount equal to the biodiesel mixture credit.[375] The biodiesel fuel mixture credit must first be taken against tax liability for taxable fuels. To the extent the biodiesel fuel mixture credit exceeds such tax liability; the excess may be received as a payment. Thus, if the person has no IRC section 4081 liability, the credit is refundable. The Secretary of the Treasury is not required to make payments with respect to biodiesel fuel mixtures sold or used after December 31, 2013.

Renewable Diesel

"Renewable diesel" is liquid fuel that: (1) is derived from biomass (as defined in IRC section 45K(c)(3)), (2) meets the registration requirements for fuels and fuel additives established by the EPA under section 211 of the Clean Air Act, and (3) meets the requirements of the ASTM D975 or D396, or equivalent standard established by the Secretary of the Treasury. ASTM D975 provides standards for diesel fuel suitable for use in diesel engines. ASTM D396 provides standards for fuel oil intended for use in fuel-oil burning equipment, such as furnaces. Renewable diesel also includes fuel derived from biomass that meets the requirements of a Department of Defense specification for military jet fuel or an ASTM specification for aviation turbine fuel.

For purposes of the IRC, renewable diesel is generally treated the same as biodiesel. In the case of renewable diesel that is aviation fuel, kerosene is treated as though it were diesel fuel for purposes of a qualified renewable diesel mixture. Like biodiesel, the incentive may be taken as an income tax credit, an excise tax credit, or as a payment from the Secretary of the Treasury.[376]

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[373] IRC section 6426(c).

[374] IRC section 6426(c)(4).

[375] IRC section 6427(e).

[376] IRC sections 40A(f), 6426(c), and 6427(e).

The incentive for renewable diesel is $1.00 per gallon. There is no small producer credit for renewable diesel. The incentives for renewable diesel expire after December 31, 2013.

New Federal Law (IRC section 40A)

The provision extends the income tax credit, excise tax credit, and payment provisions for biodiesel and renewable diesel for one year (through December 31, 2014).

Effective Date

The provision is effective for fuel sold or used after December 31, 2013.

California Law

Income Tax Credit

California does not conform to the biodiesel fuels credit.

Excise Tax Credits and Payments

The FTB does not administer fuel excise taxes. Defer to the Board of Equalization (BOE).

Impact on California Revenue

Income Tax Credit

Not applicable.

Excise Tax Credits and Payments

Defer to the BOE.

Section	Section Title
154	Extension of Production Credit for Indian Coal Facilities Placed in Service Before 2009

Background

A credit is available for the production of Indian coal sold to an unrelated third party from a qualified facility for a seven-year period beginning January 1, 2006, and ending December 31, 2013. The amount of the credit for Indian coal is $1.50 per ton for the first four years of the seven-year period and $2.00 per ton for the last three years of the seven-year period. Beginning in calendar years after 2006, the credit amounts are indexed annually for inflation using 2005 as the base year. The credit amount for 2013 is $2.308 per ton.

A qualified Indian coal facility is a facility placed in service before January 1, 2009, that produces coal from reserves that on June 14, 2005, were owned by a federally recognized tribe of Indians or were held in trust by the United States for a tribe or its members.

The credit is a component of the general business credit,[377] allowing excess credits to be carried back one year and forward up to 20 years. The credit is also subject to the alternative minimum tax.

New Federal Law (IRC section 45)

The provision extends the credit for the production of Indian coal for one year (through December 31, 2013). The placed-in-service date for qualified facilities is not extended.

Effective Date

The provision is effective for coal produced after December 31, 2013.

California Law (None)

California does not conform to the federal credit for the production of Indian coal.

Impact on California Revenue

Not applicable.

Section	Section Title
155	Extension and Modification of Credits With Respect to Facilities Producing Energy from Certain Renewable Resources

Background

Renewable Electricity Production Credit

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "renewable electricity production credit").[378] Qualified energy resources

[377] IRC section 38(b)(8).

comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

Municipal Solid Waste

One feedstock that can be used to generate credit-eligible renewable electricity is municipal solid waste. For this purpose, the term "municipal solid waste" has the meaning given the term "solid waste" under section 2(27) of the Solid Waste Disposal Act.[379] Under that Act, the term "solid waste" generally means any garbage, refuse, or sludge from a waste treatment plant, water supply treatment plant, or air pollution control facility and other discarded material, including solid, liquid, semisolid, or contained gaseous material resulting from industrial, commercial, mining, and agricultural operations, and from community activities, but does not include solid or dissolved material in domestic sewage, or solid or dissolved materials in irrigation return flows or industrial discharges. For purposes of this credit, the term "Municipal solid waste" specifically excludes commonly recycled paper that has been segregated from such waste for purposes of this credit.

Election to Claim Energy Credit in Lieu of Renewable Electricity Production Credit

A taxpayer may make an irrevocable election to have certain property which is part of a qualified renewable electricity production facility be treated as energy property eligible for a 30-percent investment credit under IRC section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production credit with respect to which no credit under IRC section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the renewable electricity production credit. The eligible basis for the investment credit for taxpayers making this election is the basis of the depreciable (or amortizable) property that is part of a facility capable of generating electricity eligible for the renewable electricity production credit.

New Federal Law (IRC sections 45 and 48)

The provision extends the renewable electricity production credit and the 30-percent investment credit in lieu of such production credit for one year, through December 31, 2014.

Effective Date

The provision is effective on January 1, 2014.

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[378] IRC section 45. In addition to the renewable electricity production credit, IRC section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

[379] IRC section 45(c)(6).

California Law (None)

California does not conform to the energy production and energy investment credits.

Impact on California Revenue

Not applicable.

Section	Section Title
156	Extension of Credit for Energy-Efficient New Homes

Background

Present law provides a credit to an eligible contractor for each qualified new energy-efficient home that is constructed by the eligible contractor and acquired by a person from such eligible contractor for use as a residence during the taxable year. To qualify as a new energy-efficient home, the home must be: (1) a dwelling located in the United States, (2) substantially completed after August 8, 2005, and (3) certified in accordance with guidance prescribed by the Secretary of the Treasury to have a projected level of annual heating and cooling energy consumption that meets the standards for either a 30-percent or 50-percent reduction in energy usage, compared to a comparable dwelling constructed in accordance with the standards of chapter 4 of the 2003 International Energy Conservation Code as in effect (including supplements) on August 8, 2005, and any applicable federal minimum efficiency standards for equipment. With respect to homes that meet the 30-percent standard, one-third of such 30-percent savings must come from the building envelope, and with respect to homes that meet the 50-percent standard, one-fifth of such 50-percent savings must come from the building envelope.

Manufactured homes that conform to federal manufactured home construction and safety standards are eligible for the credit provided all the criteria for the credit are met. The eligible contractor is the person who constructed the home, or in the case of a manufactured home, the producer of such home.

The credit equals $1,000 in the case of a new home that meets the 30-percent standard and $2,000 in the case of a new home that meets the 50-percent standard. Only manufactured homes are eligible for the $1,000 credit.

In lieu of meeting the standards of chapter 4 of the 2006 International Energy Conservation Code, manufactured homes certified by a method prescribed by the Administrator of the Environmental Protection Agency under the Energy Star Labeled Homes program are eligible for the $1,000 credit provided criteria (1) and (2), above, are met.

The credit applies to homes that are purchased prior to January 1, 2014. The credit is part of the general business credit.

New Federal Law (IRC section 45L)

The provision extends the credit to homes that are acquired prior to January 1, 2014.

Effective Date

The provision applies to homes acquired after December 31, 2013.

California Law (None)

California does not conform to the credit for energy-efficient new homes.

Impact on California Revenue

Not applicable.

Section	Section Title
157	Extension of Special Allowance for Second Generation Biofuel Plant Property

Background

Present law[380] allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified second generation biofuel plant property. In order to qualify, the property generally must be placed in service before January 1, 2015.

Qualified second generation biofuel plant property means property used in the U.S. solely to produce second generation biofuel. For this purpose, second generation biofuel means any liquid fuel which is derived by, or from, qualified feedstocks, and that meets the registration requirements for fuels and fuel additives established by the Environmental Protection Agency under section 211 of the Clean Air Act.

The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service. The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under IRC section 162 or subject to capitalization under IRC section 263 or IRC section 263A. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there is no adjustment to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property

[380] IRC section 168(l).

to which the provision applies. A taxpayer is allowed to elect out of the additional first-year depreciation for any class of property for any taxable year.

In order for property to qualify for the additional first-year depreciation deduction, it must meet the following requirements: the original use of the property must commence with the taxpayer on or after December 20, 2006, and the property must be acquired by purchase (as defined under IRC section 179(d)) by the taxpayer after December 20, 2006, and placed in service before January 1, 2014. Property does not qualify if a binding written contract for the acquisition of such property was in effect on or before December 20, 2006.

Property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer qualifies if the taxpayer begins the manufacture, construction, or production of the property after December 20, 2006, and the property is placed in service before January 1, 2014 (and all other requirements are met). Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.

Property any portion of which is financed with the proceeds of a tax-exempt obligation under IRC section 103 is not eligible for the additional first-year depreciation deduction.[381] Recapture rules apply if the property ceases to be qualified second generation biofuel plant property.[382]

Property with respect to which the taxpayer has elected 50-percent expensing under IRC section 179C is not eligible for the additional first-year depreciation deduction.[383]

New Federal Law (IRC section 168)

The provision extends the present-law special depreciation allowance for one year, to qualified second generation biofuel plant property placed in service prior to January 1, 2015.

Effective Date

The provision to extend the placed in service date is effective for property placed in service after December 31, 2013.

California Law (R&TC sections 17201 and 17250)

This provision is not applicable under California law.

[381] IRC section 168(l)(4)(C).

[382] IRC section 168(l)(7).

[383] IRC section 168(l)(8).

The Personal Income Tax Law specifically does not conform to the special allowance for cellulosic biofuel plant property,[384] and that special allowance has not been adopted under the Corporation Tax Law.[385]

Impact on California Revenue

Not applicable.

Section	Section Title
158	Extension of Energy Efficient Commercial Buildings Deduction

Background

In General

Current federal law[386] provides a deduction equal to energy-efficient commercial building property expenditures made by the taxpayer. Energy-efficient commercial building property expenditures is defined as property: (1) which is installed on or in any building located in the United States that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America ("ASHRAE/IESNA"), (2) which is installed as part of (i) the interior lighting systems, (ii) the heating, cooling, ventilation, and hot water systems, or (iii) the building envelope, and (3) which is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003). The deduction is limited to an amount equal to $1.80 per square foot of the property for which such expenditures are made. The deduction is allowed in the year in which the property is placed in service. Certain certification requirements must be met in order to qualify for the deduction. The Secretary, in consultation with the Secretary of Energy, will promulgate regulations that describe methods of calculating and verifying energy and power costs using qualified computer software based on the provisions of the 2005 California Nonresidential Alternative Calculation Method Approval Manual or, in the case of residential property, the 2005 California Residential Alternative Calculation Method Approval Manual.

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384 The Personal Income Tax Law generally conforms to modified accelerated cost recovery system provisions of IRC section 168 under R&TC section 17201, but specifically dos not conform to the special allowance for cellulosic biofuel plant property under R&TC section 17250(a)(2)(C)(8).

385 The Corporation Tax Law does not adopt the modified accelerated cost recovery system provisions of IRC section 168, and instead is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules that generally allow property to be depreciated based on its "useful life" under R&TC section 24349.

386 IRC section 179D.

The Secretary shall prescribe procedures for the inspection and testing for compliance of buildings that are comparable, given the difference between commercial and residential buildings, to the requirements in the Mortgage Industry National Accreditation procedures for Home Energy Rating Systems. Individuals qualified to determine compliance shall only be those recognized by one or more organizations certified by the Secretary for such purposes.

For energy-efficient commercial building property expenditures made by a public entity, such as public schools, the Secretary shall promulgate regulations that allow the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity.

If a deduction is allowed under this section, the basis of the property shall be reduced by the amount of the deduction.

The deduction is effective for property placed in service after December 31, 2005, and prior to January 1, 2014.

Partial Allowance of Deduction

In the case of a building that does not meet the overall building requirement of a 50-percent energy savings, a partial deduction is allowed with respect to each separate building system that comprises energy efficient property and which is certified by a qualified professional as meeting or exceeding the applicable system-specific savings targets established by the Secretary of the Treasury. The applicable system-specific savings targets to be established by the Secretary are those that would result in a total annual energy savings with respect to the whole building of 50 percent, if each of the separate systems met the system specific target. The separate building systems are: (1) the interior lighting system, (2) the heating, cooling, ventilation and hot water systems, and (3) the building envelope. The maximum allowable deduction is $0.60 per square foot for each separate system.

<u>New Federal Law (IRC section 179D)</u>

The provision extends the energy efficient commercial buildings deduction for one year, through December 31, 2014.

<u>Effective Date</u>

The provision is effective for property placed in service after December 13, 2013.

<u>California Law (R&TC sections 17255, 17257.2 and 24356)</u>

This provision is not applicable under California Law.

Under the Personal Income Tax Law, California specifically does not conform to the federal election to expense energy efficient commercial buildings,[387] and the election has not been adopted under the Corporation Tax Law. Under both the Personal Income Tax Law and the Corporation Tax Law, as it relates to the election to deduct (or "expense") costs in lieu of depreciation, California conforms to IRC section 179, with significant modifications.[388]

Taxpayers with a sufficiently small amount of annual investment may elect to deduct up to $25,000 of the cost of qualifying property placed in service for the taxable year. The $25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations.).

Impact on California Revenue

Not applicable.

Section	Section Title
159	Extension of Special Rule for Sales or Dispositions to Implement FERC or State Electric Restructuring Policy for Qualified Electric Utilities

Background

A taxpayer selling property generally recognizes gain to the extent the sales price (and any other consideration received) exceeds the seller's basis in the property. The recognized gain is subject to current income tax unless the gain is deferred or not recognized under a special tax provision.

One such special tax provision permits taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period[389] (the "reinvestment property").[390] If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain is recognized to the extent of such excess in the year of the qualifying electric transmission transaction.

[387] R&TC section 17257.2.

[388] R&TC sections 17255 and 24356.

[389] The applicable period for a taxpayer to reinvest the proceeds is the four-year period beginning on the date the qualifying electric transmission transaction occurs.

[390] IRC section 451(i).

A qualifying electric transmission transaction is the sale or other disposition of property used by a qualified electric utility to an independent transmission company prior to January 1, 2014.

A qualified electric utility is defined as an electric utility, which as of the date of the qualifying electric transmission transaction, is vertically integrated in that it is both: (1) a transmitting utility (as defined in the Federal Power Act)[391] with respect to the transmission facilities to which the election applies, and (2) an electric utility (as defined in the Federal Power Act).[392]

In general, an independent transmission company is defined as: (1) an independent transmission provider[393] approved by the Federal Energy Regulatory Commission (FERC), (2) a person (i) who the FERC determines under section 203 of the Federal Power Act (or by declaratory order) is not a "market participant" and (ii) whose transmission facilities are placed under the operational control of a FERC-approved independent transmission provider no later than four years after the close of the taxable year in which the transaction occurs, or (3) in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, (i) a person which is approved by that Commission as consistent with Texas State law regarding an independent transmission organization, or (ii) a political subdivision, or affiliate thereof, whose transmission facilities are under the operational control of an organization described in (i).

Exempt utility property is defined as: (1) property used in the trade or business of generating, transmitting, distributing, or selling electricity or producing, transmitting, distributing, or selling natural gas, or (2) stock in a controlled corporation whose principal trade or business consists of the activities described in (1). Exempt utility property does not include any property that is located outside of the United States.

If a taxpayer is a member of an affiliated group of corporations filing a consolidated return, the reinvestment property may be purchased by any member of the affiliated group (in lieu of the taxpayer).

<u>New Federal Law (IRC section 451)</u>

The provision extends for one year the treatment under the present-law deferral provision to sales or dispositions by a qualified electric utility that occur prior to January 1, 2015.

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[391] 16 U.S.C. sec. 796 (23), defines "transmitting utility" as any electric utility, qualifying cogeneration facility, qualifying small power production facility, or federal power marketing agency which owns or operates electric power transmission facilities which are used for the sale of electric energy at wholesale.

[392] 16 U.S.C. sec. 796 (22), defines "electric utility" as any person or state agency (including any municipality) which sells electric energy; such term includes the Tennessee Valley Authority, but does not include any federal power marketing agency.

[393] For example, an independent transmission provider may be a regional transmission organization, an independent system operator, or an independent transmission company.

Effective Date

The provision applies to dispositions after December 31, 2013.

California Law (R&TC sections 17551, 24661, and 24661.6)

This provision is not applicable under California law.

The Personal Income Tax Law and the Corporation Tax Law generally conform to the federal rules relating to the taxable year of inclusion;[394] however, both the Personal Income Tax Law and the Corporation Tax Law specifically do not conform to the special rule for sales or dispositions to implement FERC or state electric restructuring policy.[395]

Impact on California Revenue

Not applicable.

Section	Section Title
160	Extension of Tax Credits Relating to Certain Fuels

Background

Fuel Excise Taxes

Fuel excise taxes are imposed on taxable fuel (gasoline, diesel fuel or kerosene) under IRC section 4081. In general, these fuels are taxed when removed from a refinery, terminal rack, upon entry into the United States, or upon sale to an unregistered person. A back-up tax under IRC section 4041 is imposed on previously untaxed fuel and alternative fuel used or sold for use as fuel in a motor vehicle or motorboat to the supply tank of a highway vehicle. In general, the rates of tax are 18.3 cents per gallon (or in the case of compressed natural gas 18.3 cents per gasoline gallon equivalent), and in the case of liquefied natural gas, and liquid fuel derived from coal or biomass, 24.3 cents per gallon.

[394] Under the Personal Income Tax Law, R&TC section 17551 conforms to Subchapter E of Chapter 1 of Subtitle A of the IRC, containing IRC sections 441-483, as of the "specified date" of January 1, 2009, with modifications. Under the Corporation Tax Law, R&TC section 24661 conforms to IRC section 451, relating to the general rule for taxable year of inclusion, as of the "specified date" of January 1, 2009.

[395] R&TC sections 17551(f) and 24661.6.

Alternative Fuel and Alternative Fuel Mixture Credits and Payments

The IRC provides two per-gallon excise tax credits with respect to alternative fuel: the alternative fuel credit, and the alternative fuel mixture credit. For this purpose, the term "alternative fuel" means liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy under 42 U.S.C. sec. 13211(2)), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process ("coal-to-liquids"), compressed or liquefied gas derived from biomass, or liquid fuel derived from biomass. Such term does not include ethanol, methanol, or biodiesel.

For coal-to-liquids produced after December 30, 2009, the fuel must be certified as having been derived from coal produced at a gasification facility that separates and sequesters 75 percent of such facility's total carbon dioxide emissions.

The alternative fuel credit is allowed against IRC section 4041 liability, and the alternative fuel mixture credit is allowed against IRC section 4081 liability. Neither credit is allowed unless the taxpayer is registered with the Secretary of the Treasury. The alternative fuel credit is 50 cents per gallon of alternative fuel or gasoline gallon equivalents[396] of non-liquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat, sold for use in aviation or so used by the taxpayer.

The alternative fuel mixture credit is 50 cents per gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. An "alternative fuel mixture" is a mixture of alternative fuel and taxable fuel (gasoline, diesel fuel or kerosene) that contains at least one-tenth of one percent taxable fuel. The mixture must be sold by the taxpayer producing such mixture to any person for use as a fuel, or used by the taxpayer producing the mixture as a fuel. The credits generally expire after December 31, 2013 (September 30, 2014 for liquefied hydrogen).

A person may file a claim for payment equal to the amount of the alternative fuel credit and alternative fuel mixture credits. The alternative fuel credit and alternative fuel mixture credit must first be applied to the applicable excise tax liability under IRC section 4041 or IRC section 4081, and any excess credit may be taken as a payment. These payment provisions generally also expire after December 31, 2013. With respect to liquefied hydrogen, the payment provisions expire after September 30, 2014.

For purposes of the alternative fuel credit, alternative fuel mixture credit and related payment provisions, "alternative fuel" does not include fuel (including lignin, wood residues, or spent pulping liquors) derived from the production of paper or pulp.

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396 "Gasoline gallon equivalent" means, with respect to any non-liquid alternative fuel (for example, compressed natural gas), the amount of such fuel having a Btu (British thermal unit) content of 124,800 (higher heating value).

New Federal Law (IRC sections 6426 and 6427)

The provision extends the alternative fuel excise tax credit, and related payment provisions (for non-hydrogen fuels), for one additional year through December 31, 2014.

Effective Date

The provision is generally effective for fuel sold or used after December 31, 2013. The extension of the credit for liquefied hydrogen is effective for fuel sold or used after September 30, 2014.

California Law

The FTB does not administer fuel excise taxes. Defer to the Board of Equalization (BOE).

Impact on California Revenue

Defer to the BOE.

Section	Section Title
161	Extension of Credit for Alternative Fuel Vehicle Refueling Property

Background

Taxpayers may claim a 30-percent credit for the cost of installing qualified clean-fuel vehicle refueling property to be used in a trade or business of the taxpayer or installed at the principal residence of the taxpayer.[397] The credit may not exceed $30,000 per taxable year per location, in the case of qualified refueling property used in a trade or business and $1,000 per taxable year per location, in the case of qualified refueling property installed on property which is used as a principal residence.

Qualified refueling property is property (not including a building or its structural components) for the storage or dispensing of a clean-burning fuel or electricity into the fuel tank or battery of a motor vehicle propelled by such fuel or electricity, but only if the storage or dispensing of the fuel or electricity is at the point of delivery into the fuel tank or battery of the motor vehicle. The original use of such property must begin with the taxpayer.

Clean-burning fuels are any fuel at least 85 percent of the volume of which consists of ethanol, natural gas, compressed natural gas, liquefied natural gas, liquefied petroleum gas, or hydrogen. In addition, any mixture of biodiesel and diesel fuel, determined without regard to any use of kerosene and containing at least 20 percent biodiesel, qualifies as a clean fuel.

[397] IRC section 30C.

Credits for qualified refueling property used in a trade or business are part of the general business credit and may be carried back for one year and forward for 20 years. Credits for residential qualified refueling property cannot exceed for any taxable year the difference between the taxpayer's regular tax (reduced by certain other credits) and the taxpayer's tentative minimum tax. Generally, in the case of qualified refueling property sold to a tax-exempt entity, the taxpayer selling the property may claim the credit.

A taxpayer's basis in qualified refueling property is reduced by the amount of the credit. In addition, no credit is available for property used outside the United States or for which an election to expense has been made under IRC section 179.

The credit is available for property placed in service after December 31, 2005, and (except in the case of hydrogen refueling property) before January 1, 2014. In the case of hydrogen refueling property, the property must be placed in service before January 1, 2015.

New Federal Law (IRC section 30C)

The provision extends for one year (through 2014) the 30-percent credit for alternative fuel refueling property (other than hydrogen refueling property, the credit for which continues under present law through 2014).

Effective Date

The provision is effective for taxable years beginning after December 31, 2013.

California Law (None)

California does not conform to the alternative fuel vehicle refueling property credit.

Impact on California Revenue

Not applicable.

Section	Section Title
171	Extension of Automatic Extension of Amortization Periods

Background

Funding Rules in General

Defined benefit pension plans generally are subject to minimum funding rules under the IRC that require the sponsoring employer to periodically make contributions to fund plan benefits. Similar rules apply to defined benefit pension plans under the Labor Code provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The minimum funding rules for single-employer and multiemployer plans are different.[398] A single-employer plan is a plan that is not a multiemployer plan. A multiemployer plan is generally a plan to which more than one employer is required to contribute and which is maintained pursuant to a collective bargaining agreement.[399]

Funding Standard Account

A multiemployer defined benefit pension plan is required to maintain a special account called a "funding standard account" to which charges and credits (such as credits for plan contributions) are made for each plan year. If, as of the close of the plan year, charges to the funding standard account exceed credits to the account, the plan has an "accumulated funding deficiency" equal to the amount of such excess charges. For example, if the balance of charges to the funding standard account of a plan for a year would be $200,000 without any contributions, then a minimum contribution equal to that amount is required to meet the minimum funding standard for the year to prevent an accumulated funding deficiency. If credits to the funding standard account exceed charges, then the result is a credit balance. The amount of the credit balance, increased with interest, can be used to reduce future required contributions.

Amortization Periods

A plan is required to use an acceptable actuarial cost method to determine the elements included in its funding standard account for a year. Generally, an acceptable actuarial cost method breaks up the cost of benefits under the plan into annual charges consisting of two elements for each plan year. These elements are referred to as the: (1) normal cost; and (2) amortization of supplemental cost. The normal cost for a plan for a plan year generally represents the cost of future benefits allocated to the plan year under the funding method used by the plan for current employees. The supplemental cost for a plan year is the cost of future benefits that would not be met by future normal costs, future employee contributions, or plan assets, such as a net

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[398] The Pension Protection Act of 2006 modified the minimum funding rules for multiemployer defined benefit pension plans. These modifications are generally effective for plan years beginning after 2007.

[399] IRC section 414(f).

experience loss. Supplemental costs are amortized (i.e., recognized for funding purposes) over a specified number of years, depending on the source. The amortization period applicable to a multiemployer plan for most credits and charges is 15 years.[400] Past service liability under the plan is amortized over 15 years;[401] past service liability due to plan amendments is amortized over 15 years; and experience gains and losses resulting from a change in actuarial assumptions are amortized over 15 years. Experience gains and losses and waived funding deficiencies are also amortized over 15 years.

The Secretary, upon receipt of an application, is required to grant an extension of the amortization period for up to five years with respect to any unfunded past service liability, investment loss, or experience loss.[402] There must be included with the application a certification by the plan's actuary that: (1) absent the extension, the plan would have an accumulated funding deficiency in the current plan year and any of the nine succeeding plan years; (2) the plan sponsor has adopted a plan to improve the plan's funding status; (3) taking into account the extension, the plan is projected to have sufficient assets to timely pay its expected benefit liabilities and other anticipated expenditures; and (4) required notice has been provided. The automatic extension provision does not apply with respect to any application submitted after December 31, 2014. The Secretary may also grant an additional extension of such amortization periods for an additional five years, using the same standards for determining whether such an extension may be granted as under the pre-PPA minimum funding rules.[403]

Actuarial Assumptions

In applying the funding rules, all costs, liabilities, interest rates, and other factors are required to be determined on the basis of actuarial assumptions and methods, each of which must reasonable (taking into account the experience of the plan and reasonable expectations), or that, in the aggregate, result in a total plan contribution equivalent to a contribution that would be obtained if each assumption and method were reasonable. In addition, the assumptions are required to offer the actuary's best estimate of anticipated experience under the plan.

Valuation of Plan Assets

In determining the charges and credits to be made to the plan's funding standard account for a multiemployer plan, the value of plan assets may be determined on the basis of any reasonable actuarial method of valuation which takes into account fair market value and which is permitted

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[400] IRC section 431(b)(2). Prior to the effective date of the PPA, the amortization period was 30 years for past service liability, past service liability due to plan amendments, and losses and gains resulting from a change in actuarial assumptions.

[401] In the case of a plan in existence on January 1, 1974, past service liability under the plan on the first day on which the plan was first subject to ERISA was amortized over 40 years. In the case of a plan which was not in existence on January 1, 1974, past service liability under the plan on the first day on which the plan was first subject to ERISA was amortized over 30 years. Past service liability due to plan amendments was amortized over 30 years.

[402] IRC section 431(d)(1).

[403] IRC section 431(d)(2).

under regulations prescribed by the Secretary.[404] Thus, the actuarial value of a plan's assets under a reasonable actuarial valuation method can be used instead of fair market value. A reasonable actuarial valuation method generally can include a smoothing methodology that takes into account reasonable expected investment returns and average values of the plan assets, so long as the smoothing or averaging period does not exceed the five most recent plan years, including the current plan year. In addition, in order to be reasonable, any actuarial valuation method used by the plan is required to result in a value of plan assets that is not less than 80 percent of the current fair market value of the assets and not more than 120 percent of the current fair market value.[405] In determining plan funding under an acceptable actuarial cost method, a plan's actuary generally makes certain assumptions regarding the future experience of a plan.

The actuarial valuation method is considered to be part of the plans funding method. The same method must be used each plan year. If the valuation method is changed, the change is only permitted to take effect if approved by the Secretary of Treasury.[406]

Additional Funding Rules for Plans in Endangered or Critical Status

Under IRC section 432,[407] additional funding rules apply to a multiemployer defined benefit pension plan that is in endangered or critical status. These rules require the adoption of and compliance with: (1) a funding improvement plan in the case of a multiemployer plan in endangered status; and (2) a rehabilitation plan in the case of a multiemployer plan in critical status. In the case of a plan in critical status, additional required contributions and benefit reductions apply and employers are relieved of liability for minimum required contributions under the otherwise applicable funding rules, provided that a rehabilitation plan is adopted and followed.

IRC section 432 is effective for plan years beginning after 2007. The additional funding rules for plans in endangered or critical status do not apply to plan years beginning after December 31, 2014, except that a plan operating under a funding improvement or rehabilitation plan for its last year beginning before January 1, 2015, must continue to operate under such plan until the funding improvement or rehabilitation period (as explained below) expires or the plan emerges from endangered or critical status.

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[404] IRC section 431(c)(2).

[405] Treas. Reg. section 1.412(c)(2)-1(b). Rev. Proc. 2000-40, 2000-2 CB 357, generally indicates that only an averaging period that does not exceed five years will be approved by the IRS. The revenue procedure also indicates that for a funding valuation method to be approved, the asset value determined under the method must be adjusted to be no greater than 120 percent and no less than 80 percent of the fair market value.

[406] IRC section 412(d)(1).

[407] Parallel rules apply under ERISA.

Failure to Comply with Minimum Funding Rules

In the event of a failure to comply with the minimum funding rules, the IRC imposes a two-level excise tax on the plan sponsor.[408] The initial tax is five percent of the plan's accumulated funding deficiency for multiemployer plans. An additional tax is imposed if the failure is not corrected before the date that a notice of deficiency with respect to the initial tax is mailed to the employer by the IRS or the date of assessment of the initial tax. The additional tax is equal to 100 percent of the unpaid contribution or the accumulated funding deficiency, whichever is applicable. Before issuing a notice of deficiency with respect to the excise tax, the Secretary must notify the Secretary of Labor and provide the Secretary of Labor with a reasonable opportunity to require the employer responsible for contributing to, or under, the plan to correct the deficiency or comment on the imposition of the tax.

Temporary Automatic Extension of Amortization Periods for Multiemployer Plans

A plan sponsor of a multiemployer plan that meets a solvency test is permitted to use either one or both of two temporary special funding relief rules for either or both of two plan years.

Amortization of net investment losses

The first special funding relief rule allows the plan sponsor to treat the portion of its experience loss attributable to the net investment losses (if any) incurred in either or both of the first two plan years ending after August 31, 2008, as an item separate from other experience losses, to be amortized in equal annual installments (until fully amortized) over the period beginning with the plan year in which such portion is first recognized in the actuarial value of assets and ending in the 30-plan-year period beginning with the plan year in which the net investment loss was incurred. If this treatment is used for a plan year, the plan sponsor will not be eligible for an extension of this amortization period for this separate item, and if an extension was granted before electing this treatment of net investment losses, such extension must not result in such amortization period exceeding 30 years.

A plan sponsor is required to determine its net investment losses in the manner described by the Secretary, on the basis of the difference between actual and expected returns (including any difference attributable to any criminally fraudulent investment). The determination as to whether an arrangement is a criminally fraudulent investment arrangement shall be made under rules substantially similar to the rules prescribed by the Secretary for purposes of IRC section 165.

Expanded smoothing period and asset valuation corridor

Under the other special funding relief rule, a multiemployer plan may change its asset valuation method in a manner which spreads the difference between the expected returns and actual returns for either or both of the first two plan years ending before August 31, 2008, over a period of not more than 10 years. However, as under present law, spreading the difference between

[408] IRC section 4971. Special rules apply under IRC section 4971 for multiemployer plans in endangered or critical status.

expected and actual returns under a plan's asset valuation method is only permitted if it does not result in a value of plan assets, when compared to the current fair market value of the plan assets, to be at any time outside an asset valuation corridor.

Under this special funding relief rule, the asset valuation corridor is expanded so that, for either or both of the first two plan years ending before August 31, 2008, the plan's asset value must be adjusted under the valuation method being used so the value of plan assets is not less than 80 percent of the current fair market value of the assets and not more than 130 percent of the current fair market value (rather than 120 percent). This expanded valuation corridor is available whether or not the plan sponsor increases the period for spreading the difference between expected and actual returns under its asset valuation method. If a plan sponsor uses either or both of the options (extending the spreading period and the expanded asset valuation corridor) under this special relief rule for one or both of these plan years, the Secretary will not treat the asset valuation method of the plan as unreasonable because of such change and the change will be deemed to be approved by the Secretary.

Amortization of Reduction in Unfunded Accrued Liability

To the extent a plan sponsor uses both of the two special funding relief rules for any plan year, the plan is required to treat any resulting reduction in the plan's unfunded accrued liability as a separate experience amortization base. This separate experience amortization base is amortized in annual installments (until fully amortized) over a period of 30 plan years (rather than the otherwise applicable amortization period).

Solvency Test

The solvency test is satisfied only if the plan actuary certifies that the plan is projected to have sufficient assets to timely pay expected benefits and anticipated expenditures over the amortization period taking into account the changes in the funding standard account under the special funding relief rule elected.

Benefit Restriction

If a plan sponsor of a multiemployer plan uses one, or both, of the special funding relief rules under this provision, then, in addition to any other applicable restrictions on benefit increases, the following limit also applies. A plan amendment increasing benefits may not go into effect during either of the two plan years immediately following any plan year to which such election first applies unless one of the following conditions is satisfied: either the plan actuary certifies that such increase is paid for out of additional contributions not allocated to the plan at the time the election was made, and the plan's funded percentage and projected credit balances for such two plan years are reasonably expected to be generally at the same levels as such percentage and balances would have been if the benefit increase had not been adopted, or the amendment is required to maintain the plan's status as a qualified retirement plan under the applicable provisions of the IRC or to comply with other applicable law.

Reporting

A plan sponsor of a multiemployer plan that uses one or both of these special funding relief rules must give notice to participants and beneficiary of its use of the relief and must inform the PBGC of its use of the relief in such form and manner, as the Director of the PBGC may prescribe.

Termination

The temporary automatic extension of amortization periods for multiemployer plans applies to extension applications submitted before January 1, 2015.

New Federal Law (IRC section 431)

The provision modifies ERISA and the IRC to extend, for one year, the temporary automatic extension of amortization periods for multiemployer plans.

Effective Date

The provision is effective for applications submitted after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[409] including this provision's extension of the automatic extension of amortization periods.

ERISA Preemption

ERISA preempts state laws affecting pension plans; thus, the parallel extension under ERISA automatically applies to pension plans in California.

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[409] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Impact on California Revenue

Baseline.

Section	Section Title
172	Extension of Shortfall Funding Method and Endangered and Critical Rules Appliances

Background

An uncodified provision of the Pension Protection Act of 2006 (PPA)[410] provides that under ERISA and the IRC, the rules applicable to plans in endangered and critical status and the rules relating to the automatic amortization extension and shortfall funding method under the general funding rules for multiemployer plans do not apply to plan years beginning after December 31, 2014. The pre-PPA rules are reinstated for such years, except that funding improvement and rehabilitation plans and amortization schedules in effect at the time of the sunset continue.

New Federal Law (Uncodified Act section 172 Affecting IRC section 412)

The provision extends, for one year, the uncodified PPA rules applicable to plans in endangered and critical status and the rules relating to the automatic amortization extension and shortfall funding method under the general funding rules for multiemployer plans; such rules are extended to apply to plan years beginning before January 1, 2016.

Effective Date

The provision is effective for plan years beginning after December 31, 2014.

California Law (R&TC section 17501)

IRC Conformity

In general, California automatically conforms to the federal pension rules,[411] including this provision's extension of the automatic extension of amortization periods.

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[410] Section 221 of the Pension Protection Act of 2006, Public Law 109-280.

[411] R&TC section 17501 conforms to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of Part I (IRC sections 401 to 420, relating to pension, profit-sharing, stock bonus plans, etc.), Part II (IRC sections 421 to 424, relating to certain stock options), and Part III (IRC sections 430 to 436, relating to rules relating to minimum funding standards and benefit limitations).

Except for increases in the maximum amount of elective deferrals that may be excluded from income under IRC section 402(g), R&TC section 17501(b) specifically provides that federal changes to Part I (IRC sections 401 to 420) and Part III (IRC sections 430 to 436) of Subchapter D of Chapter 1 of Subtitle A of the IRC automatically apply without regard to taxable year to the same extent as applicable for federal income tax purposes, and thus adopt all

ERISA Preemption

ERISA preempts state laws affecting pension plans; thus, the parallel extension under ERISA automatically applies to pension plans in California.

Impact on California Revenue

Baseline.

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changes made to the IRC sections within those parts without regard to the "specified date" contained in R&TC section 17024.5.

Introduction

This Act includes technical corrections to recently-enacted tax legislation. Except as otherwise provided, the amendments made by the technical corrections contained in the Act take effect as if included in the original legislation to which each amendment relates.

Section	Section Title
202	Amendments Relating to American Taxpayer Relief Act of 2012

New Federal Law (IRC sections 55, 168, 642, 911, and 6431)

a. Phase Out of Personal Exemption Amount for Qualified Disability Trusts (Act section 101(b))

The provision corrects an obsolete statutory reference to the computation of the exemption amount for a qualified disability trust.

California Law (R&TC section 17732)

California specifically does not conform to the personal exemption amount for estates and trusts. Thus, this provision is not applicable under California law.

Impact on California Revenue

Not applicable.

b. Capital Gain Rate for Certain High-Income Individuals (Act section 102)

The provision contains a conforming amendment to the computation of the foreign earned income exclusion.

California Law (R&TC section 17024.5(b)(8))

California specifically does not conform to the federal foreign income exclusion. Thus, this provision is not applicable under California law.

Impact on California Revenue

Not applicable.

c. Permanent Alternative Minimum Tax Relief for Individuals (Act section 104)

The provision clarifies that, as adjusted for inflation, the exemption amount for married individuals filing a separate return is one-half the exemption amount for married individuals filing a joint return. The provision also clarifies that the exemption amount for individuals filing a joint return, as adjusted for inflation, is rounded to the nearest $100.

California Law (R&TC sections 17062, 23400, and 23455)

California law conforms to federal AMT rules as of the "specified date" of January 1, 2009, with modifications.[412] As a result, the California AMT is similar to federal AMT in many respects, but California has its own AMT exemption amounts that are indexed for California inflation. Thus, this provision is not applicable for California purposes.

Impact on California Revenue

Not applicable.

d. Qualified Zone Academy Bonds (Act section 310)

The provision makes changes to the IRC to conform to Congressional intent that qualified zone academy bonds cannot be issued as direct-pay bonds using national limitation allocations or carry forwards from years after 2010.

California Law (None)

California does not conform to qualified zone academy bonds; thus, this provision is not applicable under California law.

Impact on California Revenue

Not applicable.

e. Election to Accelerate the AMT Credit in Lieu of Bonus Depreciation (Act section 331)

The provision clarifies the taxable year for which an election under IRC section 168(k)(4) is made.

California Law (R&TC sections 17201 and 17250)

This provision is not applicable under California law. The Personal Income Tax Law specifically does not conform to bonus depreciation,[413] and bonus depreciation has not been adopted under the Corporation Tax Law.

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[412] R&TC sections 17062 and 23400 conform to Part VI of Subchapter A of Chapter 1 of Subtitle A of the IRC, containing IRC sections 55 to 59, as of the "specified date" of January 1, 2009, with modifications.

[413] R&TC section 17250(a)(2)(C)(4).

Impact on California Revenue

Not applicable.

Section	Section Title
203	Amendment Relating to Middle Class Tax Relief and Job Creation Act of 2012

New Federal Law (IRC section 6655)

Repeal of Certain Shifts in Timing of Corporate Estimated Tax Payments (Act section 7001)

The provision corrects a reference to the repeal of certain shifts in the timing of estimated corporate taxes with respect to the Corporate Estimated Tax Shift Act of 2009 (Public Law 111-42).

California Law (R&TC section 19025)

California does not conform to the federal rules relating to estimated corporate taxes, and instead provides its own rules for corporate estimated tax payments; thus, this provision is not applicable under California law.

Impact on California Revenue

Not applicable.

Section	Section Title
204	Amendment Relating to FAA Modernization and Reform Act of 2012

New Federal Law (IRC section 4281)

Small Aircraft on Non-established Lines (Act section 1107)

Under IRC section 4281, small aircraft (excluding jet aircraft) that are operated on non-established lines and for sightseeing are exempt from the taxes imposed on the transportation of persons and property by air. The provision clarifies that rotorcraft (i.e., helicopters) and propeller aircraft are not “jet aircraft” for purposes of IRC section 4281.

California Law

The FTB does not administer aviation taxes. Defer to the Board of Equalization (BOE).

Impact on California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

Section	Section Title
205	Amendments Relating to Regulated Investment Company Modernization Act of 2010

New Federal Law (IRC sections 851, 852, 855, 1212, and 4982)

a. Capital loss carryovers (Act section 101)

The Act provided capital loss carryover treatment for a regulated investment company (RIC) similar to the net capital loss carryovers applicable to individuals. The provision is effective for taxable years beginning after December 22, 2010. The IRS ruled that this provision is effective for purposes of the excise tax under IRC section 4982 for calendar years after 2010.[414] Thus, the provision applies to one-year periods beginning after October 31, 2010, which are taken into account in computing the excise tax for calendar years beginning after 2010.

Capital loss carryovers under the Act are used prior to capital loss carryovers under the provisions of prior law. As a result of the interaction of these rules, there are situations where capital loss carryovers may expire for purposes of the excise tax but not for purposes of determining investment company taxable income.

The provision allows a RIC to elect to delay the new capital loss carryover provisions for purposes of IRC section 4982 for one calendar year so that the provision will apply to one-year periods beginning after October 31, 2011, which are taken into account in computing the excise tax for calendar years beginning after 2011. The provision also provides that the capital loss carryovers of a RIC will not prevent the RIC from having sufficient earnings and profits to make the required distribution of its capital gain net income under IRC section 4982 (as provided in IRC section 852(c)(2)).

[414] Rev. Rul. 2012-29, 2012-42 I. R. B. 475.

California Law

California does not conform to the excise tax under IRC section 4982; thus, this provision is not applicable under California law.

Impact on California Revenue

Not Applicable.

b. Spillover dividends (Act section 304)

The Act provides that a spillover dividend must be declared before the later of the 15th day of the 9th month following the close of the taxable year or the extended due date for filing the return for the taxable year. The provision provides the declaration may be made on or before the relevant date.

California Law (R&TC sections 17088 and 24870)

California conforms to the RIC spillover dividend rules as amended by this Act (i.e., as amended by the Regulated Investment Company Modernization Act of 2010).[415] However, California does not conform to this provision's technical correction to the RIC spillover dividend rules.

Impact of California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

c. Certain Late-Year Losses (Act section 308)

Under present and prior law, the amount which may be treated as a capital gain dividend for a taxable year of a RIC is determined without regard to the post-October capital loss for the year, and the post-October capital loss is treated as arising on the first day of the next taxable year. Under the law in effect prior to the enactment of the Act, the term "post-October capital loss" was defined as any net capital loss attributable to the portion of the taxable year after October 31, or if there was no net capital loss, any net-long term capital loss attributable to the portion of the taxable year after that date.[416] Under the Act, the term "post-October capital loss" is the greatest of (i) the net capital loss attributable to the portion of the taxable year after October 31, (ii) the net-long term capital loss attributable to the portion of the taxable year after that date, or (iii) the net-short term capital loss attributable to the portion of the taxable year after that date.

[415] R&TC sections 17088 and 24870 conform to Subchapter M of Chapter 1 of Subtitle A of the IRC, consisting of IRC sections 851 to 860G, as amended by the Regulated Investment Company Modernization Act of 2010 (Public Law 111-325), with modifications.

[416] Treas. Reg. section 1.852-11. Also, Notice 97-64, 1997-2 C.B. 323, provides guidance on the application of the multiple tax rates under IRC section 1(h) to capital gain dividends of RICs.

Under the provision, the term "post-October capital loss" is the net capital loss attributable to the portion of the taxable year after October 31, or if there is no net capital loss, any net long-term capital loss or any net short-term capital loss attributable to the portion of the taxable year after that date.

Under prior law, to the extent provided in regulations, a RIC could elect to push the post-October net foreign currency losses and the net reduction in the value of stock in a PFIC (passive foreign investment company) with respect to which an election is in effect under IRC section 1296(k) forward to the next taxable year. Regulations had been issued allowing RICs to elect to defer all or part of any post-October net foreign currency losses for the portion of the taxable year after October 31 to the first day of the succeeding taxable year. The Act expanded this rule to provide that any late-year ordinary loss may be deferred.

The provision corrects the definition of late-year ordinary loss by defining the loss to be the sum of the post-October specified loss (if any) and the post-December ordinary loss (if any). The provision does not apply to an election made before the date of enactment of this Act for a taxable year ending before that date where the election to defer losses was made in accordance with the provisions of present law.

California Law (R&TC sections 18151, 18155, 24990, and 24990.5)

California law generally conforms to the federal rules for capital loss carryovers as of the "specified date" of January 1, 2009,[417] modified to provide that California conforms to the RIC late-year loss rules as amended by this Act (i.e., as amended by the Regulated Investment Company Modernization Act of 2010).[418] However, California does not conform to this provision's technical correction to RIC late-year loss rules.

Impact of California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

d. Deferral of Certain Gains and Losses for Excise Tax Purposes (Act section 402)

For purposes of the IRC section 4982 excise tax, the Act applies the mark-to-market provisions of the IRC and regulations thereunder as if the taxable year ended on October 31. Also, the Act allows a taxable-year RIC, except as provided in regulations, to elect to "push" any net ordinary loss (determined without regard to ordinary gains and losses that are automatically "pushed" to the next calendar year) attributable to the portion of the calendar year after the beginning of the taxable year that begins in the calendar year to the first day of the next calendar year.

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[417] R&TC sections 18151 and 24990 conform to Subchapter P of Chapter 1 of Subtitle A of the IRC, containing IRC sections 1201 to 1298, as of the "specified date" of January 1, 2009, with modifications.

[418] R&TC sections 18155 and 24990.5.

The provision provides that any rule that determines income by reference to the value of an item on the last day of the taxable year is treated as a mark-to-market provision for which value will be determined on October 31 for purposes of the excise tax.

The provision allows a RIC to elect to push any portion of a net ordinary loss to the next calendar year in determining its ordinary income or net ordinary loss for a calendar year.

California Law

California does not conform to the excise tax under IRC section 4982; thus, this provision is not applicable under California law.

Impact on California Revenue

Not Applicable.

Section	Section Title
206	Amendments Relating to Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

New Federal Law (IRC sections 32, 1397B, 2001 and 2801)

a. Indexing of Amount of Reduction of Marriage Penalty for Earned Income Credit (Act section 103)

The earned income tax credit in IRC section 32 is clarified to provide that the $5,000 amount, by which the phase-out thresholds for married couples filing jointly are increased, is indexed for inflation for all taxable years after 2009, not just taxable years beginning in 2010.

California Law

California does not conform to the federal earned income credit.

Impact on California Revenue

Not applicable.

b. Nonrecognition of Gain on Rollover of Empowerment Zone Investments (Act section753)

IRC section 1397B is clarified to provide that the provision applies to qualified empowerment zone assets acquired after December 21, 2000, and before January 1, 2014. Under the provision, taxpayers can elect to defer recognition of gain on the sale of a qualified empowerment zone asset held for more than one year and replaced within 60 days by another qualified empowerment zone asset in the same zone.

California Law

California does not conform to the federal empowerment zone tax incentives.

Impact on California Revenue

Not applicable.

Section	Section Title
207	Amendments Relating to Small Business Jobs Act of 2010

New Federal Law (IRC section 6722)

Failure to Furnish Correct Payee Statements (Act section 2102)

The provision clarifies that the effective date for the amendments to both IRC section 6721 and IRC section 6722 applies with respect to both information returns required to be filed and payee statements required to be furnished on or after January 1, 2011.

California Law (R&TC section 19183)

California law conforms to the federal penalty amounts for the failure to file information returns[419] and for the failure to furnish payee statements[420] as of the "specified date" of January 1, 2009. As a result, California law does not conform to penalty increases made by the Creating Small Business Jobs Act of 2010[421] to IRC sections 6721 and 6722. Thus, this technical correction to clarify the effective date for the amendments made by the Creating Small Business Jobs Act of 2010 to both IRC section 6721 and IRC section 6722 is not applicable under California law.

Impact on California Revenue

Not applicable.

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[419] R&TC section 19183(a) conforms to the penalty amounts under IRC section 6721 as of the "specified date" of January 1, 2009.

[420] R&TC section 19183(b) conforms to penalty amounts under IRC section 6722 as of the "specified date" of January 1 2009.

[421] The "Creating Small Business Jobs Act of 2010" is Title II of the Small Business Jobs Act of 2010, Public Law 112-240.

Section Title

Section	Section Title
208	Clerical Amendment Relating to Hiring Incentives to Restore Employment Act

New Federal Law (IRC section 6662)

Section 512 of the Act imposes a 40-percent accuracy-related penalty on any understatement attributable to an undisclosed foreign financial asset. This provision makes a clerical amendment to Section 512(a) of the Act to correct a reference.

California Law (R&TC section 19164)

California conforms to the 40-percent accuracy-related penalty on any understatement attributable to an undisclosed foreign financial asset,[422] but does not conform to this provision's clerical amendment.

Impact of California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

Section	Section Title
209	Amendments Relating to American Recovery and Reinvestment Act of 2009

New Federal Law (IRC sections 24, 25A, 30, 30D, 35, 38, 45Q, 48, 48C, 164, 853A, 1016, 6428, and 6432)

a. Refundable Portion of Child Credit for Certain Taxable Years (Act section 1003)

The child tax credit in IRC section 24 is clarified regarding the determination of the refundable credit in any taxable years beginning after 2008 and before 2018. The provision provides that, to the extent that the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15 percent of earned income in excess of $3,000 not indexed for inflation (in lieu of $10,000 indexed for inflation). The present-law alternative formula for families with three or more children is unchanged.

California Law

California law does not conform to the federal child credit.

[422] R&TC section 19164(a)(1)(A) conforms to the accuracy-related penalty under IRC section 6662 as amended by the Health Care and Education Reconciliation Act of 2010 (Public Law 111-152), except as otherwise provided.

Impact on California Revenue

Not applicable.

b. American Opportunity Tax Credit (Act section 1004)

The Act includes a reference to "tuition, fees, and course materials." The reference to course materials was intended to apply to the Hope credit, but not to the Lifetime learning credit. The provision corrects this reference to the inclusion of course materials so that it applies only to the Hope credit and not to the Lifetime learning credit.

California Law

California law does not conform to the federal American Opportunity Tax Credit.

Impact on California Revenue

Not applicable.

c. Deduction for State Sales Tax and Excise Tax on the Purchase of Certain Motor Vehicles (Act section 1008)

The Act provides an itemized deduction and increased standard deduction for qualified motor vehicle taxes. The provision strikes IRC section 164(b)(6)(E) (which refers to the last sentence of IRC section 164(a)) as inoperative, because the taxes referred to in that last sentence do not include qualified motor vehicle taxes.

California Law (R&TC section 17201)

This provision is not applicable under California law. R&TC section 17201 conforms to IRC section 164 as of the "specified date" of January 1, 2009, with modifications in R&TC section 17220; thus, California does not conform to the federal deduction for state sales tax on excise tax on the purchase of certain motor vehicles, which was enacted on February 17, 2009, and expired for purchases made after December 31, 2009.

Impact on California Revenue

Not applicable.

d. Coordination with Renewable Energy Grants (Act section 1104)

The provision provides that grants in lieu of energy credits under section 1603 of the Act are not includible in alternative minimum taxable income (including adjusted current earnings of a corporation). This treatment is consistent with the treatment of energy credits.

California Law (R&TC sections 17131.3 and 24303)

Under the Personal Income Tax Law and the Corporation Tax Law, any energy grant made in any taxable year by the Secretary of the Treasury under Section 1603 of the American Recovery and Reinvestment Act is excluded from gross income and from alternative minimum taxable income.

Impact on California Revenue

Not applicable.

e. Credits for Certain Vehicles and Refueling Property (Act sections 1141 and 1142, and sections 1341 and 1342 of the Energy Tax Incentives Act of 2005 (Public Law 109-58))

The provisions conform the rules relating to the amount of basis reduction, as well as the reduction of other credits and deductions, on account of the credits for certain vehicles and refueling property under IRC sections 30, 30B, 30C, and 30D.

California Law

California does not conform to the federal credits for certain vehicles and refueling property.

Impact on California Revenue

Not applicable.

f. Qualifying Advanced Energy Project Credit (Act section 1302)

The provision restores missing words, clarifying that the amount subject to the limitation in IRC section 48C(b)(3) is the amount that is treated as the qualified investment.

California Law

California does not conform to the federal qualifying advanced energy property credit.

Impact on California Revenue

Not applicable.

g. Regulated Investment Companies Allowed to Pass Through Tax Credit Bond Credits (Act section 1541)

The provision clarifies that a regulated investment company electing to pass through credits on tax credit bonds, and its shareholders, are treated in a manner similar to that which would occur if the company distributed to its shareholders an amount of money equal to the amount of the credits passed through.

California Law

California does not conform to the federal tax credit bond credits.

Impact on California Revenue

Not applicable.

h. Special Credit for Certain Government Retirees (Act section 2202)

The provision clarifies the credit with respect to treatment of the U.S. possessions. The provision is intended to operate in a manner similar to the operation of the Making Work Pay Credit with respect to the U.S. possessions (see H.R. Rep. 111-16, February 12, 2009, at 516-517).

California Law

California does not conform to the federal special credit for certain government retirees.

Impact on California Revenue

Not applicable.

Section	Section Title
210	Amendments Relating to Energy Improvement and Extension Act of 2008

New Federal Law (IRC sections 45, 45K, 168, 907, 1012, 6045, and 9501)

a. Credit for Steel Industry Fuel (Act Division B, Title I, Subtitle A, section 108)

The provision clarifies that coke and coke gas produced using fuel qualifying for a steel industry fuel credit is not eligible for the credit under present-law IRC section 45K(g).

California Law

California does not conform to the federal credit for steel industry fuel.

Impact on California Revenue

Not applicable.

b. Temporary Increase in Coal Excise Tax; Funding of Black Lung Disability Trust Fund (Act Division B, Title I, Subtitle B, section 113)

The provision clarifies that the term "trust fund" means the Black Lung Disability Trust Fund.

California Law

The FTB does not administer these types of excise taxes; defer to the Board of Equalization (BOE).

Impact on California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

c. Accelerated Recovery Period for Depreciation of Smart Meters and Smart Grid Systems (Act Division B, Title III, section 306)

The provision clarifies that the accelerated recovery period for smart meters and smart grid systems does not apply to property with a class life of less than 16 years.

California Law (R&TC sections 17201, 17250, 24349, 24355.3 and 24355.4)

The accelerated recovery period for smart meters and smart grid systems are allowed under the federal modified accelerated cost recovery system (MACRS).

The Personal Income Tax Law generally conforms to MACRS with certain modifications as of the specified date of January 1, 2009, and conforms to the accelerated recovery period for depreciation of smart meters and smart grid systems, but does not conform to this provision's technical clarification.

Under the Corporation Tax Law, California does not conform to MACRS. Instead, the Corporation Tax Law is in substantial conformity to the pre-1981 federal asset depreciation range (ADR) deduction, which is based on the useful life of depreciable property.

Impact on California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

d. Special Depreciation Allowance for Certain Reuse and Recycling Property (Act Division B, Title III, section 308)

Consistent with the intent of the Act, the provision clarifies that a taxpayer does not qualify for the special depreciation allowance under this provision if it elects out of bonus depreciation under IRC section 168(k)(4), which permits a taxpayer to accelerate the recognition of alternative minimum tax and research credits in lieu of claiming bonus depreciation. This conforms to the parallel rule in IRC section 168(n)(2)(B)(i)(I) (excluding such property from the definition of qualified disaster assistance property) under the qualified disaster assistance property provisions.

California Law (R&TC sections 17201 and 17250)

The special depreciation allowance for certain reuse and recycling property is allowed under the federal modified accelerated cost recovery system (MACRS).

The Personal Income Tax Law generally conforms to MACRS with certain modifications as of the specified date of January 1, 2009; but specifically does not conform to special depreciation allowance for certain reuse and recycling property.[423]

Under the Corporation Tax Law, California does not conform to MACRS. Instead, the Corporation Tax Law is in substantial conformity to the pre-1981 federal asset depreciation range (ADR) deduction, which is based on the useful life of depreciable property.

Impact on California Revenue

Not applicable.

e. Special Rules in Case of Foreign Oil and Gas Income (Act Division B, Title IV, section 402)

The Act expands the foreign oil and gas extraction income (FOGEI) rules to apply to all foreign income from production and other activity related to the sale of oil and gas product (the sum of prior-law foreign oil-related income (FORI) and FOGEI). A transition rule in the Act unintentionally fails to properly apply pre-effective date law to pre-2009 credit carry forwards. The provision clarifies that pre-2009 credits carried forward to post-2008 years continue to be governed by prior law for purposes of determining the amount of carry forward credits eligible to be claimed in a post-2008 year.

California Law

California law does not conform to the foreign tax credit, thus the FOGEI and FORI limitations to that credit are not applicable for state purposes.

Impact on California Revenue

Not applicable.

[423] R&TC section 17250(a)(9).

f. Broker Reporting of Customer's Basis in Securities Transactions (Act Division B, Title IV, section 403)

The provision makes conforming changes necessitated by the deletion of the defined term "open-end fund," so that the provision refers to regulated investment companies rather than open-end funds.

The Act provides a definition of a dividend reinvestment plan (DRP), and also permits use of average cost basis for stock acquired after December 31, 2010, in connection with a DRP. The Act further provides that stock acquired before 2012 for which an average basis method is permissible is treated as a separate account from any such stock acquired after 2011, and provides an election for a regulated investment company to treat as a single account all stock held by a customer without regard to the date of acquisition of the stock. For stock for which an average basis method is permissible, the Act's basis reporting requirements apply to stock acquired after December 31, 2011. The provision conforms the effective date for the availability of an average basis method for DRP stock to the effective date for the basis-reporting requirement for stock for which an average basis method is permissible by making the former rule applicable to DRP stock acquired after December 31, 2011 (rather than December 31, 2010).

The provision makes a conforming change to the effective date provision applicable to required basis reporting related to DRP stock. Under this change, unless a broker elects otherwise, basis reporting for DRP stock remains mandatory, as under the Act, only for stock acquired on or after January 1, 2012.

The provision also clarifies that if an election is made to treat as a single account all stock acquired in connection with a DRP, the average basis method is permissible with respect to all such stock without regard to the date of acquisition of the stock.

California Law (R&TC section 18631)

California does not conform by reference to IRC section 6045, relating to returns of brokers, but instead provides in R&TC section 18631 that a copy of the federal information return is required to be filed with the FTB upon request. More specifically, R&TC section 18631(c)(7), requires the filing of a copy of the federal information return filed under IRC section 6045, relating to returns of brokers, upon request of the FTB. Because R&TC section 18631(c)(7) requires the filing of a copy of the federal information return filed under IRC section 6045, the return received by the FTB will contain the information mandated by Section 403 of the Energy Improvement and Extension Act of 2008, as amended by this provision's technical amendments. Thus, California has effectively pre-conformed to federal technical corrections made by this provision.

Impact on California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

Section	Section Title
211	Amendments Relating to Tax Extenders and Alternative Minimum Tax Relief Act of 2008

New Federal Law (IRC sections 56, 143, 165, 168, 172, 897, and 1033)

Qualified Investment Entities (Act Division C,[424] section 208)

The Act generally extends the inclusion of a RIC within the definition of a "qualified investment entity" under the Foreign Investment in Real Property Tax Act (FIRPTA) rules of IRC section 897 through December 31, 2009. The Act imposes withholding tax on certain RIC distributions to foreign shareholders; however, distributions may have been made after the provision had expired on December 31, 2007, but before the extension was enacted. The provision clarifies that no withholding is required for distributions that were made on or before the date of enactment (October 4, 2008). The provision also clarifies that a RIC is not liable to a foreign shareholder to whom a distribution was made before October 4, 2008, for amounts that were withheld from such a distribution and paid over to the Secretary.

California Law (R&TC sections 25110 and 25116)

California does not generally conform to the federal rules for sourcing the income for foreign corporations, except for certain foreign corporations doing business in California. Those corporations, which have a water's-edge election in force, are required to use federal sourcing rules, such as those set forth in IRC sections 861 through 865 and IRC sections 897(g) and (h), as applicable for federal purposes, to determine United States source income, including rules for foreign corporations. In other words, California already conforms to these technical corrections for water's-edge purposes.

Impact on California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

Section	Section Title
212	Clerical Amendments Relating to Housing Assistance Tax Act of 2008

New Federal Law (IRC sections 42, 121, and 168)

This provision makes clerical corrections to IRC sections 42(b), 121(b), and 168(k)(4)(E).

[424] The Tax Extenders and Alternative Minimum Tax Relief Act of 2008 is Division C of the Emergency Economic Stabilization Act of 2008 (Public Law 110-343).

California Law (R&TC sections 17131)

IRC section 42(b)

The Personal Income Tax Law and the Corporation Tax Law conform to IRC section 42, relating to the low-income housing credit, as of the "specified date" of January 1, 2009.[425] Thus, California law does not conform to this provision's clerical corrections to IRC section 42(b).

IRC section 121(b)

The Personal Income Tax Law conforms to IRC section 121, relating to limitations on exclusion of gain from sale of principal residence, as of the specified date of January 1, 2009.[426] Thus, California law does not conform to this provision's clerical corrections to IRC section 121(b).

IRC section 168(k)(4)(E)

This clerical amendment is not applicable under California law.

The Personal Income Tax Law specifically does not conform to bonus depreciation.[427]

The Corporation Tax Law does not allow bonus depreciation, and instead is generally in substantial conformity to the pre-1981 federal asset depreciation range (ADR) depreciation rules that generally allow property to be depreciated based on its "useful life."[428]

Impact of California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

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[425] R&TC sections 17058 and 23610.5 conform to IRC section 42 as of the "specified date" of January 1, 2009, with modifications.

[426] R&TC section 17131 conforms to IRC section 121 as of the "specified date" of January 1, 2009, with modifications.

[427] R&TC section 17250(a)(2)(C)(4).

[428] R&TC section 24349.

Section	Section Title
213	Amendments and Provisions Relating to Heroes Earnings Assistance and Relief Act of 2008

New Federal Law (IRC sections 121, 125, 877, and 6511)

a. Special Period of Limitation When Uniformed Services Retired Pay is Reduced as Result of Award of Disability Compensation (Act section 106)

The provision clarifies that the date of enactment, June 17, 2008, applies for purposes of the portion of the transition rule specifying what date should be substituted for the date of the determination.

California Law (R&TC sections 19306 and 19311)

The federal extension of the time limit for filing a claim for refund or credit (i.e., the statute of limitations) for retired military personnel who receive disability determinations from the Department of Veterans affairs after one or more tax returns have been filed results in an extension of the California statute of limitations for filing such claims for refund or credit.

California does not conform to the federal rules under IRC section 6511 that provide the federal statute of limitations for filing a claim for credit or refund, but instead provides its own limitations. In general, R&TC section 19306 provides that a claim for refund or credit of tax paid by return must be filed within the later of: (1) four years from the date the return was filed (or the due date of the return, if earlier), or (2) one year from the date the tax was paid.

Additionally, R&TC section 19311 provides that a claim for refund or credit resulting from a change or correction allowed by the Commissioner of Internal Revenue or other officer of the United States or other competent authority must be filed within two years from the date of the final federal determination, or within the period provided in R&TC sections 19306, 19307, 19308, or 19316, whichever expires later.

Impact on California Revenue

Not applicable.

b. Disposition of Unused Health Benefits in Flexible Spending Accounts (Act section 114)

The Act provides that a plan does not fail to be treated as a cafeteria plan or health flexible spending arrangement (FSA) merely because the plan provides for qualified reservist distributions. The provision clarifies that a plan does not fail to be treated as an accident or health plan under IRC section 105 merely because it provides for qualified reservist distributions.

California Law (R&TC section 17131)

California law conforms to IRC section 125, relating to cafeteria plans, as of the "specified date" of January 1, 2009, with modifications. Thus, California conforms to section 114 of the Heroes Earnings Assistance and Relief Act that provides that a plan does not fail to be treated as a cafeteria plan or FSA merely because the plan provides for qualified reservist distributions, but does not conform to this provision's technical clarification.

Impact of California Revenue

No impact. No federal revenue impact was estimated for these technical corrections.

Section	Section Title
214	Amendments Relating to Economic Stimulus Act of 2008

New Federal Law (IRC sections 168 and 6213)

2008 Recovery Rebates for Individuals (Act section 101)

The provision clarifies that summary assessment procedures can apply with respect to the omission of any correct valid identification number that is required.

California Law

California law does not conform to the federal 2008 recovery rebates for individuals.

Impact on California Revenue

Not applicable.

Section	Section Title
215	Amendments Relating to Tax Technical Corrections Act of 2007

New Federal Law (IRC sections 56 and 911)

Act section 4(c)

The provision reinstates a part of IRC section 911, relating to the netting of disallowed deductions against excluded income, which was inadvertently deleted by the Act.

California Law (R&TC section 17024.5(b)(8)

California law specifically does not conform to IRC section 911, relating to residents of the United States living abroad.

Impact on California Revenue

Not applicable.

Section	Section Title
216	Amendment Relating to Tax Relief and Healthcare Act of 2006

New Federal Law (IRC section 45A)

WOTC and Indian Employment Credit (Act section 105)

IRC section 45A(b)(1)(B) coordinates the Indian employment credit with the work opportunity tax credit (WOTC). It provides that wages are not taken into account during the one-year period beginning on the date the individual begins work for the employer if wages are taken into account under the WOTC. In 2006, a second year was added to the WOTC for long-term family assistance recipients (IRC section 51(e)). The provision clarifies that the two-year period is taken into account for purposes of section 45A(b)(1)(B) if any portion of wages are taken into account under subsection (e)(1)(A) of IRC section 51.

California Law

California law does not conform to the WOTC or to the Indian Employment Credit.

Impact on California Revenue

Not applicable.

Section	Section Title
217	Amendment Relating to Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005: A Legacy for Users

New Federal Law (IRC section 9503)

Transfer to Highway Trust Fund of Amounts Equivalent to Certain Taxes and Penalties (Act section 11161)

The taxes on aviation fuel and aviation gasoline, imposed on removal from a terminal directly into the fuel tank of an aircraft, are credited to the Airport and Airways Trust Fund (IRC section 9502(b)(1)(D)). The provision makes a technical amendment to IRC section 9503(b)(1)(D) to clarify that the Highway Trust Fund is not credited with these same amounts.

California Law

Not applicable.

Impact on California Revenue

Not applicable.

Section	Section Title
218	Amendments Relating to Energy Tax Incentives Act of 2005

New Federal Law (IRC sections 30B and 30C)

Alternative Motor Vehicle Credit (Title XIII, Subtitle A, section 1341)

The Act makes minor technical corrections to the alternative motor vehicle fuel credit and the alternative fuel vehicle refueling property credit.

California Law

California does not conform to the federal alternative motor vehicle fuel credit or to the alternative fuel vehicle refueling property credit.

Impact on California Revenue

Not applicable.

Section	Section Title
219	Amendments Relating to American Jobs Creation Act of 2004

New Federal Law (IRC sections 114, 199 and 904)

a. ETI and IRC Section 199 Circularity (Act section 101)

The provision incorporates an ordering rule for purposes of IRC section 114 that requires the computation of the IRC section 114 extraterritorial income ("ETI") exclusion without regard to the IRC section 199 deduction. Under this ordering rule, a taxpayer must first compute the amount of the IRC section 114 exclusion, determined without regard to the IRC section 199 deduction, before the taxpayer computes its IRC section 199 deduction. As under present law, any amount excluded from gross income pursuant to IRC section 114 continues to be taken into account in determining qualified production activities income. The provision is consistent with technical corrections previously made to provide ordering rules to avoid circular calculations resulting from the interaction between the computations under IRC section 199 and IRC sections 163(j), 170, and 613A.

California Law (R&TC section 17132)

This provision is not applicable under California law. The ETI exclusion under IRC section 114 was repealed by the American Jobs Creation Act of 2004,[429] and prior to its repeal, California law specifically did not conform to IRC section 114.

Impact on California Revenue

Not applicable.

b. Section 199 W-2 Wages (Act section 102)

Section 199(b)(2)(A) provides that the amounts included as W-2 wages are only those amounts paid during the calendar year ending during the taxable year of a taxpayer. In some instances, this results in taxable years in which no W-2 wages are included *(e.g.*, short years that do not include December 31). Consequently, in such instances, the taxpayer may be precluded from claiming an IRC section 199 deduction due to the W-2 wage limitation. Although IRC section 199(b)(3) provides the Secretary with authority to address cases in which there may be a short taxable year as a result of a taxpayer's acquisition or disposition of a trade or business (or a major portion of a separate unit of a trade or business), it does not provide explicit authority to address other circumstances that result in a short taxable year (e.g., change in accounting period).

The provision provides the Secretary the authority to issue guidance for short taxable years (outside of the context of an acquisition or disposition) permitting the allocation of W-2 wages to a short taxable year that does not include the end of a calendar year. For example, the Secretary may issue guidance that permits a taxpayer to allocate a portion of the annual W-2 wages to a

[429] Section 101 of Public Law 108-357.

short taxable year that does not include the end of the calendar year and the full amount of such W-2 wages to the subsequent 12-month taxable year that includes such calendar year end.

California Law (R&TC sections 17201.6)

This provision is not applicable under California law. Under the Personal Income Tax Law, California specifically does not conform to the deduction for income attributable to domestic production activities, and the deduction has not been adopted under the Corporation Tax Law.

Impact on California Revenue

Not applicable.

Section	Section Title
220	Other Clerical Corrections

The Act includes a number of clerical and conforming amendments that are effective upon enactment.

Section	Section Title
221	Deadwood

A number of provisions in the IRC are not used in computing current taxes and thus are obsolete. These provisions are referred to as “deadwood.” The bill repeals 17 sections of the IRC and repeals or amends portions of more than 100 other sections of the IRC to remove deadwood. The provision does not change substantive law.

The amendments relating to deadwood made by the provision are effective on the date of enactment. The provision includes savings provisions to mitigate the effects of repealing the deadwood items in the event those items have any remaining applicability to past transactions. For example, if a transfer of property took place before the date of enactment, the basis of the property is not changed by reason of any provision of the bill that amends a IRC section relating to the determination of basis.

Section	Section Title
301	Increased Refund and Credit Threshold for Joint Committee on Taxation Review of C Corporation Returns

Background

No refund or credit in excess of $2,000,000 of any income tax, estate or gift tax, or certain other specified taxes may be made until 30 days after the date a report on the refund is provided to the Joint Committee on Taxation (IRC section 6405). A report is also required in the case of certain tentative refunds. Additionally, the staff of the Joint Committee on Taxation conducts post-audit reviews of large deficiency cases and other select issues.

New Federal Law (IRC section 6405)

The Act increases the threshold above which refunds of C corporations must be submitted to the Joint Committee on Taxation for review from $2,000,000 to $5,000,000.

California Law

California has no comparable provision.

Impact on California Revenue

Not applicable.

Sections	Section Titles
102	Qualified ABLE Programs

Background

Qualified Tuition Programs

In General

IRC section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.[430] A qualified tuition program is a program established and maintained by a state or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program"). In the case of a program established and maintained by a state or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a "savings account program"). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary's higher education expenses.

For this purpose, qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time.

New Federal Law (New IRC sections 26, 501, 529, 529A, 877A, 4965, 4973, and 6693)

Qualified ABLE Programs

The provision provides rules for a new type of tax-favored savings program, qualified ABLE programs. A qualified ABLE program is a program established and maintained by a state or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an "ABLE account"), established for the purpose of meeting the qualified disability expenses of the

[430] The term "account" refers to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; (3) the program must allow for the establishment of ABLE accounts only for a designated beneficiary who is either a resident of the state maintaining such ABLE program or a resident of a state that has not established an ABLE program (a "contracting state") which has entered into a contract with such state to provide the contracting state's residents with access to the state's ABLE program; and (4) the program must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations.

A designated beneficiary of an ABLE account must be an eligible individual (defined below) who is designated at the commencement of participation in the qualified ABLE program as the beneficiary of amounts paid (or to be paid) into the program. Additionally, a designated beneficiary may be a brother, sister, stepbrother or stepsister of the former designated beneficiary of the ABLE account, provided such new designated beneficiary is also an eligible individual.

Contributions to an ABLE account must be made in cash and are not deductible for federal income tax purposes. Under the provision, except in the case of a rollover contribution from another account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the amount under IRC section 2503(b) (the annual gift tax exemption). For 2014, this is $14,000.[431] Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program[432] of the state maintaining the qualified ABLE program. Amounts in the account accumulate on a tax-deferred basis (*i.e.*, income on accounts in the plan is not subject to current income tax).

A qualified ABLE program may not permit any contributor to, or designated beneficiary under, the program to direct (directly or indirectly) the investment of any contributions (or earnings thereon), and must provide separate accounting for each designated beneficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan.

Distributions from an ABLE account are generally includible in the distributee's income to the extent consisting of earnings on the account.[433] Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the beneficiary during the taxable year. If a distribution from an ABLE account exceeds the qualified disability expenses of the beneficiary, a pro-rata portion of the distribution is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary. Amounts in an ABLE account may be rolled over without income tax liability to

[431] This amount is indexed for inflation. In the case that contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary. Such tax does not apply in the event that the trustee of such account makes a corrective distribution of such excess amounts within the taxable year.

[432] Rules for qualified tuition programs are contained in IRC section 529.

[433] The rules of IRC section 72 apply in determining the portion of a distribution that consists of earnings.

another ABLE account for the same beneficiary[434] or another ABLE account for the designated beneficiary's brother, sister, stepbrother or stepsister who is also an eligible individual.

Under the provision, if, during any taxable year of an eligible individual, more than one ABLE account exists for such individual, each such ABLE account other than the earliest established ABLE account shall cease to be an ABLE account as of the first day of such taxable year. In this case, the designated beneficiary of the non-qualifying ABLE account shall be treated as having received a distribution of the fair market value of all the non-qualifying ABLE account's assets on the first day of such taxable year. The provision provides the Secretary of the Treasury ("Secretary") with the authority to prescribe regulations to enforce the one-ABLE-account limitation.

Under the provision, a contribution to an ABLE account is treated as a completed gift of a present interest to the beneficiary of the account. Such contributions qualify for the per-donee annual gift tax exclusion ($14,000 for 2014) and, to the extent of such exclusion, are exempt from the generation skipping transfer ("GST") tax. A distribution from an ABLE account generally is not subject to gift tax or GST tax. Those taxes apply, however, to a change of designated beneficiary during any taxable year unless, as of the beginning of the year, the new beneficiary is both an eligible individual for the taxable year and a brother, sister, stepbrother or stepsister of the former beneficiary.

Eligible Individuals

As described above, under the provision, a qualified ABLE program may provide for the establishment of ABLE accounts only if those accounts have as their designated beneficiary an eligible individual. For these purposes, an eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who has been determined, for purposes of Social Security Disability Insurance benefits or Supplemental Security Income ("SSI") benefits[435] to meet the requirements relating to disability or blindness described below. A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual meets the requirements relating to disability or blindness described below and that includes a copy of the individual's diagnosis relating to the individual's relevant impairment or impairments, signed by a licensed physician.[436]

For purposes of the requirements relating to disability or blindness, the definitions of blind and disabled under the SSI program apply ("SSI definitions").[437] In general, an individual must be

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[434] For instance, if an eligible individual were to relocate to a different state, then that individual would be allowed to roll over an ABLE account without income tax liability to another ABLE account for the same beneficiary.

[435] These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

[436] No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

[437] Section 1614(a)(2) and (a)(3) of the Social Security Act. Under the applicable definition, an individual is generally disabled if unable to engage in any substantial gainful activity by reason of any medically determinable physical or

either blind or disabled, and the blindness or disability must have occurred before the date on which the individual attained age 26. An individual who has not reached age 19 during the taxable year must be blind or must be disabled under the SSI definition applicable to an individual under the age of 18.

As discussed further below, the provision provides that, not later than six months after the date of enactment, the Secretary shall develop regulations or other guidance on certain aspects of the provision. Among these aspects are regulations, to be developed in consultation with the Commissioner of Social Security, relating to disability certifications and determinations of disability including those conditions which are deemed to have occurred prior to age 26, with limited evidence required by the individual as to this requirement.

Qualified Disability Expenses

As described above, the earnings on distributions from an ABLE account are only untaxed to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For these purposes, qualified disability expenses are any expenses related to the eligible individual's blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of this provision.

Reporting Requirements

Under the provision, each officer or employee having control of the qualified ABLE program (or their designees) is required to make reports to the Secretary and to the designated beneficiaries of ABLE accounts. Such reports must provide information with respect to contributions, distributions, the return of excess contributions, and other matters as required by the Secretary. In addition, for research purposes, such officers and employees shall make available to the public and provide to the Secretary, reports containing aggregate information, by diagnosis and other relevant characteristics, on contributions and distributions.

However, an item of information may not be made publically available if it can be associated with, or otherwise identify, directly or indirectly, a particular individual.

The provision also requires that the trustee of an ABLE account submit a notice to the Secretary upon the establishment of the ABLE account. Such notice shall contain the name and state of residence of the beneficiary, and other such information as the Secretary may require. These

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mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of at least 12 months. An individual under the age of 18 is disabled if having a medically determinable physical or mental impairment that results in marked and severe functional limitations and that can be expected to result in death or that has lasted or can be expected to last for a continuous period of at least 12 months.

reports and notices must be filed at such time and in such manner as required by the Secretary. A penalty of $50 may apply with respect to any failure to provide a required report or notice.

Additionally, for purposes of the rules relating to eligibility for SSI (discussed below), officers and employees having control of a qualified ABLE program must submit statements on distributions from all ABLE accounts to the Commissioner of the Social Security Administration. The statements must be submitted electronically on at least a monthly basis in the manner specified by the Commissioner of the Social Security Administration.

Transfer to State

Under the provision, in the event that the designated beneficiary dies, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, all amounts remaining in the deceased beneficiary's ABLE account not in excess of the amount equal to the total medical assistance paid such individual under any state Medicaid plan established under title XIX of the Social Security Act shall be distributed to such state upon filing of a claim for payment by such state. Such repaid amounts shall be net of any premiums paid from the account or by or on behalf of the beneficiary to a Medicaid Buy-In program.

Regulations

The Secretary is directed to issue regulations or other guidance as the Secretary determines is necessary or appropriate to carry out the purposes of the qualified ABLE program rules, including regulations (1) to enforce the one ABLE account per eligible individual limit; (2) providing for the information required to be presented to open an ABLE account; (3) to generally define disability expenses; (4) relating to disability certifications and determinations of disability, to be developed in consultation with the Commissioner of Social Security, as discussed above; (5) to prevent fraud and abuse with respect to amounts claimed as qualified disability expenses; (6) under the estate tax, gift tax, and generation-skipping transfer tax provisions of the IRC; and (7) to allow for transfers from one ABLE account to another ABLE account in cases in which an eligible individual has a change in state of residence. The Secretary is directed to issue such regulations or other guidance no later than six months after December 19, 2014.

Effective Date

The provision is effective for taxable years beginning after December 31, 2014. The directive that requires the Secretary to issue regulations within six months, and the disregard of ABLE accounts and distributions from such accounts in the case of certain means-tested federal programs, are effective on December 19, 2014.

California Law

California does not conform to newly-enacted IRC section 529A relating to qualified ABLE programs.

Impact on California Revenue

Estimated Conformity Revenue Impact of Qualified ABLE Programs For Taxable Years Beginning On or After January 1, 2016 Enactment Assumed After June 30, 2015		
2015-16	2016-17	2017-18
- $100,000	- $400,000	- $900,000

This estimate is based on a proration of the federal estimate developed for this provision by the Joint Committee on Taxation (JCT). The JCT estimates that revenue losses are projected to continue to increase, and the prorating the last year included in the JCT estimate would result in a loss of approximately $10 million in fiscal year 2025-26.

Section	Section Title
103	Treatment of ABLE Accounts under Certain Federal Programs

New Federal Law (IRC section 529A)

Any amounts in an ABLE account, and any distribution for qualified disability expenses, shall be disregarded for purposes of determining eligibility to receive, or the amount of, any assistance or benefit authorized by any federal means-tested program. However, in the case of the SSI program, distributions for housing expenses are not disregarded, nor are amounts in an ABLE account in excess of $100,000. In the case that an individual's ABLE account balance exceeds $100,000, such individual's SSI benefits shall not be terminated, but instead shall be suspended until such time as the individual's resources fall below $100,000. However, such suspension shall not apply for purposes of Medicaid eligibility.

California Law (None)

Not applicable.

Impact on California Revenue

Not applicable.

Section	Section Title
105	Investment Direction Rule for 529 Plans

New Federal Law (IRC section 529)

The provision amends IRC section 529(b) to permit contributors to or beneficiaries of a qualified tuition program (i.e., a 529 program) to direct the investment of contributions to a 529 program (or any earnings thereon) up to two times in any calendar year (under prior law, no investment direction was allowed).

California Law (R&TC section 17140.3)

California law conforms to IRC section 529, relating to qualified tuition programs, as of the "specified date" of January 1, 2009, and as a result does not conform to this provisions changes to IRC section 529(b) relating to investment direction.

Impact on California Revenue

Negligible—the Joint Committee on Taxation estimates that this provision would have a negligible revenue impact.

Section	Section Title
205	Modification Relating to Inland Water Ways Trust Fund Financing Rate

Background

An excise tax is imposes a tax on any liquid used during any calendar quarter by any person as a fuel in a vessel in commercial waterway transportation.

New Federal Law (IRC section 4042)

This provision amends the IRC to increase the Inland Waterways Trust Fund financing rate from 20 cents per gallon to 29 cents per gallon.

Effective Date

The provision is effective for fuel used after March 31, 2015.

California Law

The FTB does not administer fuel excise taxes. Defer to the Board of Equalization (BOE).

Impact on California Revenue

Defer to the BOE.

Section	Section Title
206	Certified Professional Employer Organizations

New Federal Law (New IRC sections 3302, 3303, 3501, 3511, 6052, 6053, 7701, 7705, and 7528)

This provision amends the IRC to treat Internal Revenue Service (IRS)-certified professional employer organizations (PEOs) as employers for employment tax purposes (thus allowing such PEOs to pay wages and collect and remit payroll taxes on behalf of an employer).

The provision also sets forth IRS certification requirements for PEOs, including independent financial review and reporting requirements. A PEO is required, each year, to post a bond equal to the greater of 5 percent of the PEO's liability during the preceding calendar year (not exceeding $1,000,000), or $50,000.

California Law

The FTB does not administer employment taxes. Defer to the Employment Development Department (EDD).

Impact on California Revenue

Defer to the EDD.

Section	Section Title
207	Exclusion of Dividends from Controlled Foreign Corporations from the Definition of Personal Holding Company Income for Purposes of the Personal Holding Company Rules

Background

The rules of subpart F[438] require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation (CFC) to include certain income of the CFC (referred to as "subpart F income") on a current basis for U.S. tax purposes, regardless of whether the income is distributed to the shareholders.

Subpart F income includes foreign base company income. One category of foreign base company income is foreign personal holding company income. For subpart F purposes, foreign personal holding company income generally includes dividends, interest, rents, and royalties, among other types of income. There are several exceptions to these rules. For example, foreign personal holding company income does not include dividends and interest received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized, or rents and royalties received by a CFC from a related corporation for the use of property within the country in which the CFC is organized. Interest, rent, and royalty payments do not qualify for this exclusion to the extent that such payments reduce the subpart F income of the payor. In addition, subpart F income of a CFC does not include any item of income from sources within the United States that is effectively connected with the conduct by such CFC of a trade or business within the United States ("ECI") unless such item is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a tax treaty.

New Federal Law (IRC section 543)

This provision amends the personal holding company rules to exclude dividends received by a U.S. shareholder from a CFC from the definition of personal holding company income for purposes of personal holding company taxation.

[438] IRC sections 951–964.

California Law (R&TC sections 25110 and 25116)

California law does not conform to IRC section 543, relating to personal holding company income, or to the subpart F rules under IRC sections 951 through 971. However, relating to the water's-edge election, the Corporation Tax Law specifically provides that the amount of a CFC's income and apportionment factors included in California taxable income when the CFC has federal subpart F income is determined by multiplying these items by the ratio, the numerator of which is the CFC's federal subpart F income for the current year, and the denominator of which is the CFC's current year federal earnings and profits, as defined by IRC section 964. Subpart F income, as defined in IRC section 952, includes:

- Insurance income;[439]
- Foreign base company income;[440]
- International boycott income;[441]
- Income from illegal bribes and kickbacks;[442] and
- Foreign country income ineligible for the foreign tax credit.[443]

When applying provisions of the IRC in connection with a water's-edge election that are otherwise not applicable, such as subpart F rules, the federal rules—as applicable for federal purposes—apply.[444] Thus, under California water's-edge rules, the one-year extension of the look-thru rule automatically applies.

Impact on California Revenue

Baseline.

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[439] IRC section 953.

[440] IRC section 954.

[441] IRC sections 952(a)(3) and 999.

[442] IRC section 952(a)(4).

[443] IRC sections 901(j) and 952(a)(5).

[444] R&TC section 25116.

Section	Section Title
208	Inflation Adjustment for Certain Civil Penalties under the Internal Revenue Code of 1986

Background

Civil Tax Penalties in General

The IRC provides for both civil and criminal penalties to ensure complete and accurate reporting of tax liability and to discourage fraudulent attempts to defeat or evade tax. Civil and criminal penalties are applied separately. Thus, a taxpayer convicted of a criminal tax offense may be subject to both criminal and civil penalties, and a taxpayer acquitted of a criminal tax offense may nonetheless be subject to civil tax penalties. In cases involving both criminal and civil penalties, the IRS generally does not pursue both simultaneously, but delays pursuit of civil penalties until the criminal proceedings have concluded.

The majority of delinquent taxes and penalties are collected through the civil process. In determining whether a penalty applies along with an adjustment to a tax return, the examining agent is constrained not only by the applicable statutory provisions, but also by the written policy of the IRS not to treat penalties as bargaining points but instead to develop facts sufficient to support the decision to assert or not to assert a penalty.[445] The goal is to ensure consistency, fairness and predictability in administration of penalties.

Civil penalties are provided in Chapter 68 of the IRC (IRC sections 6651-6751). In general, there is a penalty for (i) fraud, (ii) failure to pay or file (referred to as delinquency penalties), (iii) failure to deposit estimated tax amounts, (iv) negligence, substantial understatement, substantial valuation misstatements, substantial overstatement of pension liabilities, substantial estate or gift tax valuation understatement, lack of economic substance, and undisclosed foreign financial asset understatements, and understatements with respect to reportable transactions (all of the items in this list are referred to as accuracy-related penalties), (v) not filing or filing incorrect information returns, and (vi) aiding and abetting understatements, taking unreasonable return positions (applied to return preparers), promoting abusive tax shelters, and failing to furnish information regarding tax shelters (referred to collectively as the preparer, promoter, and protestor penalties).

Certain Penalties

a. Failure to File Tax Return or Pay Tax

Under present law, a taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent.[446] An exception from the penalty applies if the failure is

[445] Policy Statement 20-1, Internal Revenue Manual, sec. 1.2.20.1.1.

[446] IRC section 6651(a)(1).

due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.[447]

In the case of a failure to file a tax return within 60 days of the due date, present law imposes a minimum penalty equal to the lesser of $135 or 100 percent of the amount of tax required to be shown on the return.

New Federal Law (IRC section 6651)

This provision provides that in the case of any return required to be filed in a calendar year beginning after 2014, the $135 amount will be increased by an annual inflation adjustment.

Effective Date

The provision applies to returns required to be filed after December 31, 2014.

California Law (R&TC section 19131)

California does not conform by reference to IRC section 6651, relating to failure to file tax return or to pay tax, but instead has stand-alone language that parallels the federal provision. California law provides that a taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to five percent of the net amount of tax due for each month that the return is not filed, up to a maximum of five months or 25 percent.[448] An exception from the penalty applies if the failure is due to reasonable cause. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.[449]

In the case of a failure to file a tax return within 60 days of the due date, California law imposes a minimum penalty equal to the lesser of $135 or 100 percent of the amount of tax required to be shown on the return.[450]

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[447] IRC section 6651(b)(1).

[448] R&TC section 19131(a).

[449] R&TC section 19131(c).

[450] R&TC section 19131(b).

Impact on California Revenue

Estimated Conformity Revenue Impact of Annual Inflation Increases to the Penalty for Failure to File Tax Return or Pay Tax For Returns Filed in a Calendar Year Beginning After 2015 Enactment Assumed After June 30, 2015		
2015-16	2016-17	2017-18
$1,200,000	$2,600,000	$3,600,000

This estimate is based on current penalties collected by the FTB from taxpayers who failed to file a tax return or pay the tax due. In 2012, approximately $180 million in penalties were assessed for the failure to file tax return or pay tax. This amount is grown by the estimated growth in annual penalty assessments of 5.1 percent, resulting in estimated penalties of approximately $220 million in 2016. Applying an inflation adjustment to the penalties expected to be collected in 2016 is estimated to result in additional penalty revenue of approximately $2.1 million. The taxable-year estimates are converted to fiscal-year estimates, and then rounded to arrive at the estimates shown in the table above.

b. Tax Return Preparer's Failure to Furnish Copies to Taxpayers

A tax return preparer is defined as any person who prepares for compensation, or who employs other people to prepare for compensation, all or a substantial portion of an income tax return or claim for refund, and certain non-income tax returns, such as estate and gift, excise, or employment tax returns.[451]

A tax return preparer who prepares a return or claim for refund who fails to furnish a completed copy of such return or claim to the taxpayer not later than the time such return is presented for the taxpayer's signature is assessed a penalty of $50 per failure, unless it is shown the failure is due to reasonable cause and not willful neglect, not to exceed a maximum penalty of $25,000 for all failures per calendar year.[452]

New Federal Law (IRC section 6695)

This provision provides that in the case of any failure of relating to a return or claim for refund filed in a calendar year beginning after 2014, the penalty amounts for a tax return preparer's failure to furnish timely copies to taxpayers will be increased by an annual inflation adjustment.

Effective Date

The provision applies to returns required to be filed after December 31, 2014.

[451] IRC section 7701(a)(36).

[452] IRC section 6695.

California Law (R&TC sections 19167)

California conforms to the federal penalty for a tax return preparer's failure to furnish copies to taxpayers as of the "specified date" as of January 1, 2009. Thus, the California penalty for any tax return preparer who prepares a return or claim for refund who fails to furnish a completed copy of such return or claim to the taxpayer not later than the time such return is presented for the taxpayer's signature is $50 per failure, not to exceed $250,000 per calendar year, and the penalty amounts are not adjusted for inflation.

Impact on California Revenue

Negligible.

c. Failure to File Certain Information Returns, Registration Statements, Etc.

If an exempt organization fails to file a required return by the due date (including any extensions of time), it must pay a penalty of $20 a day for each day the return is late. The same penalty applies if the organization does not give all the information required on the return or does not give the correct information.

In general, the maximum penalty for any return is the lesser of $10,000 or 5 percent of the organization's gross receipts for the year. For an organization that has gross receipts of over $1 million for the year, the penalty is $100 a day up to a maximum of $50,000.

If the organization is subject to this penalty, the IRS may specify a date by which the return of correct information must be filed. If the return is not filed by that date, an individual within the organization who fails to comply may be charged a penalty of $10 a day. The maximum penalty on all individuals for failures with respect to a return shall not exceed $5,000.

New Federal Law (IRC section 6652)

This provision provides that in the case of any return required to be filed in a calendar year beginning after 2014, the penalty amounts for failure to file certain information returns, registration statements, etc., will be increased by an annual inflation adjustment.

Effective Date

The provision applies to returns required to be filed after December 31, 2014.

California Law (R&TC section 23772)

California does not conform to the federal penalty under IRC section 6652 for failure to file certain information returns, registration statements, etc. but instead has stand-alone language that generally parallels the federal provision. California law provides that in the case of an exempt organization's failure to file a return, a penalty is imposed in the amount of $5 for each month that the failure continues, not to exceed $40, unless it is shown that the failure is due to reasonable cause.[453]

Impact on California Revenue

Negligible.

d. Failure to File Partnership Returns

Background

Partnerships are generally treated as pass-through entities that do not incur an income tax at the entity level. Income earned by a partnership, whether distributed or not, is taxed to the partners. Distributions from the partnership generally are tax-free. The items of income, gain, loss, deduction or credit of a partnership generally are taken into account by a partner as allocated under the terms of the partnership agreement. If the agreement does not provide for an allocation, or the agreed allocation does not have substantial economic effect, then the items are to be allocated in accordance with the partners' interests in the partnership. To prevent double taxation of these items, a partner's basis in its interest is increased by its share of partnership income (including tax-exempt income), and is decreased by its share of any losses (including nondeductible losses).

Under present law, partnerships are required to file tax returns for each taxable year.[454] The partnership's tax return is required to include the names and addresses of the individuals who would be entitled to share in the taxable income if distributed and the amount of the distributive share of each individual.

In addition to applicable criminal penalties, present law imposes assessable civil penalties for the failure to file a partnership return.[455] The penalty is currently $195 times the number of partners for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months.

New Federal Law (IRC section 6698)

This provision provides that in the case of any partnership return required to be filed in a calendar year beginning after 2014, the $195 per-partner penalty amount will be increased by an annual inflation adjustment.

Effective Date

The provision applies to returns required to be filed after December 31, 2014.

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[453] R&TC section 23772(c)(1).

[454] IRC section 6031.

[455] IRC section 6698.

California Law (R&TC section 19172)

California does not conform to federal penalty for failure to file a partnership return, but instead has a stand-alone penalty that parallels the federal penalty for failure to file partnership returns, except that the California penalty is $18 per partner (rather than $195 per partner for federal purposes) for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months.[456]

Impact on California Revenue

Negligible.

e. *Failure to File S Corporation Returns*

Background

S corporations are generally treated as pass-through entities that do not incur an income tax at the entity level. An S corporation generally is not subject to corporate-level income tax on its items of income and loss. Instead, the S corporation passes through its items of income and loss to its shareholders. The shareholders take into account separately their shares of these items on their individual income tax returns.

Under present law, S corporations are required to file tax returns for each taxable year.[457] The S corporation's tax return is required to include the following: the names and addresses of all persons owning stock in the corporation at any time during the taxable year; the number of shares of stock owned by each shareholder at all times during the taxable year; the amount of money and other property distributed by the corporation during the taxable year to each shareholder and the date of such distribution; each shareholder's pro rata share of each item of the corporation for the taxable year; and such other information as the Secretary may require.

In addition to applicable criminal penalties, present law imposes assessable civil penalties for the failure to file an S corporation return.[458] The penalty is currently $195 times the number of shareholders or partners for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months.

New Federal Law (IRC section 6699)

This provision provides that in the case of any S corporation return required to be filed in a calendar year beginning after 2014, the $195 per-shareholder penalty amount will be increased by an annual inflation adjustment.

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[456] R&TC section 19172.

[457] IRC section 6037.

[458] IRC section 6699.

Effective Date

The provision applies to returns required to be filed after December 31, 2014.

California Law (R&TC section 19172.5)

California does not conform to federal penalty for failure to file an S corporation return, but instead has a stand-alone penalty that parallels the federal penalty for failure to file S corporation returns, except that the California penalty is $18 per shareholder (rather than $195 per shareholder for federal purposes) for each month (or fraction of a month) that the failure continues, up to a maximum of 12 months.[459]

Impact on California Revenue

Negligible.

f. Failure to File Correct Information Returns & Failure to File Correct Payee Statements

Background

Present law imposes information reporting requirements on participants in certain transactions. Under IRC section 6721, any person who is required to file a correct information return who fails to do so on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, the correct information return is filed. If a person files a correct information return after the prescribed filing date but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty is $30 per return (the "first-tier penalty"), with a maximum penalty of $250,000 per calendar year. If a person files a correct information return after the date that is 30 days after the prescribed filing date but on or before August 1, the amount of the penalty is $60 per return (the "second-tier penalty"), with a maximum penalty of $500,000 per calendar year. If a correct information return is not filed on or before August 1 of any year, the amount of the penalty is $100 per return (the "third-tier penalty") with a maximum penalty of $1,500,000 per calendar year. If a failure is due to intentional disregard of a filing requirement, the minimum penalty for each failure is $250, with no calendar-year limit.

Special lower maximum levels for this penalty apply to small businesses. Small businesses are defined as firms having average annual gross receipts for the most recent three taxable years that do not exceed $5 million. The maximum penalties for small businesses are: $75,000 (instead of $250,000) if the failures are corrected on or before 30 days after the prescribed filing date; $200,000 (instead of $500,000) if the failures are corrected on or before August 1; and $500,000 (instead of $1,500,000) if the failures are not corrected on or before August 1.

IRC section 6722 imposes penalties for failing to furnish correct payee statements to taxpayers. A first-tier penalty is $30, subject to a maximum of $250,000; a second-tier penalty is $60 per

[459] R&TC section 19172.5.

statement, up to $500,000, and the third-tier penalty is $100, up to a maximum of $1,500,000. The penalty also provides limitations on penalties for small businesses and increased penalties for intentional disregard that parallel the penalty for failure to furnish information returns.

Both the failure-to-file and failure-to-furnish penalties are adjusted to account for inflation every five years with the first adjustment to take place after 2012, effective for each year thereafter.

New Federal Law (IRC sections 6721 and 6722)

This provision provides that in the case of any failure to file a correct information return required to be filed in a calendar year beginning after 2014, and any failure to file a correct payee statement required to be furnished in a calendar year beginning after 2014, will be increased by an annual inflation adjustment.

Effective Date

The provision applies to returns required to be filed after December 31, 2014.

California Law (R&TC section 19183)

California conforms to the federal penalty amounts for the failure to file information returns[460] and for the failure to furnish payee statements[461] as of the "specified date" of January 1, 2009. Because this provision was enacted after the "specified date," California does not conform to this provision to annually increase the penalty amounts for inflation. Additionally, California does not conform to the increases to the federal penalty amounts that were enacted in 2010.[462]

Under California law, if a person files a correct information return after the prescribed filing date but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty is $15 per return (the "first-tier penalty"), with a maximum penalty of $75,000 per calendar year. If a person files a correct information return after the date that is 30 days after the prescribed filing date but on or before August 1, the amount of the penalty is $30 per return (the

[460] R&TC section 19183(a).

[461] R&TC section 19183(b).

[462] Section 2102 of the Small Business Jobs Act of 2010 (Public Law 111-240) amended IRC section 6721 to increase the first-tier penalty from $15 to $30, and to increase the calendar-year maximum from $75,000 to $250,000. The second-tier penalty was increased from $30 to $60, and the calendar-year maximum was increased from $150,000 to $500,000. The third-tier penalty was increased from $50 to $100, and the calendar-year maximum was increased from $250,000 to $1,500,000. For small business filers, the calendar year maximum was increased from $25,000 to $75,000 for the first-tier penalty, from $50,000 to $200,000 for the second-tier penalty, and from $100,000 to $500,000 for the third-tier penalty. The minimum penalty for each failure due to intentional disregard was increased from $100 to $250.

IRC section 6722, which under prior law generally imposed a $50 penalty for each failure to provide a payee statement, up to a maximum of $100,000, and increased that penalty amount if the failure was due to intentional disregard, was revised by the Small Business Jobs Act of 2010 to provide the current-law tiers and caps described above in the Background section.

"second-tier penalty"), with a maximum penalty of $150,000 per calendar year. If a correct information return is not filed on or before August 1 of any year, the amount of the penalty is $50 per return (the "third-tier penalty") with a maximum penalty of $250,000 per calendar year. If a failure is due to intentional disregard of a filing requirement, the minimum penalty for each failure is $100, with no calendar-year limit.

Special lower maximum levels for this penalty apply to small businesses. Small businesses are defined as firms having average annual gross receipts for the most recent three taxable years that do not exceed $5 million. The maximum penalties for small businesses are: $25,000 (instead of $75,000) if the failures are corrected on or before 30 days after the prescribed filing date; $50,000 (instead of $150,000) if the failures are corrected on or before August 1; and $100,000 (instead of $250,000) if the failures are not corrected on or before August 1.

For failing to furnish correct payee statements to taxpayers the California penalty amount is $50 for each failure to furnish a payee statement, up to a maximum of $100,000. If the failure is due to intentional disregard, the amount of the penalty per failure is increased[463] and the cap on the penalty is not applicable.

Impact on California Revenue

Negligible.

Section	Section Title
209	Increase in Continuous Levy

New Federal Law (IRC section 6331)

This provision amends the IRC to increase from 15 to 30 percent the rate of the continuous levy on payments due to a Medicare provider or supplier for overdue taxes.

California Law

Not applicable.

Impact on California Revenue

Not applicable.

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[463] IRC section 6722(c)(1), as in effect on January 1, 2009, provided that the penalty per failure was the greater of $100 or a fixed percentage of the aggregate items to be shown on the payee statements. The fixed amount was 10 percent for statements other than those required under IRC sections 6045(b), 6041A(e), 6050H(d), 6050J(e), 6050K(b), or 6050L(c). The penalty was the greater of $100 or five percent of the amount required to be shown on statements required under IRC sections 6045(b), 6050K(b) or 6050L(c).

EXHIBIT A – 2014 MISCELLANEOUS FEDERAL ACTS IMPACTING THE IRC NOT REQUIRING A CALIFORNIA RESPONSE

1. Public Law 113-76, the Consolidated Appropriations Act, 2014, amends the IRC to provide notes [tables] relating to IRC sections 7801 and 9501.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
7801	113-76	-	189
7801	113-76	-	189
9501	113-76	-	355

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2. Public Law 113-94, an Act to amend the IRC to terminate the entitlement of any major or minor political party to a payment from the Presidential Election Campaign Fund for a presidential nominating convention, and transfers amounts in each account maintained for such purpose for the national committee of a party to a 10-Year Pediatric Research Initiative Fund, making them available only for allocation to national research institutes and national centers through the Common Fund for making grants for pediatric research under this Act.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
1	113-94	1	1085
9008	113-94	2(a)	1085
9006	113-94	2(b)(1)	1085
9037	113-94	2(b)(2)	1085
9009	113-94	2(c)(1)	1085
9012	113-94	2(c)(2)	1086

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3. Public Law 113-121, the Water Resources Reform and Development Act of 2014, amends the IRC to make a conforming amendment to IRC section 9505, relating to expenditures from the Harbor Maintenance Trust Fund.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
9505	113-121	2102(c)	1278

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4. Public Law 113-128, the Workforce Innovation and Opportunity Act, amends the IRC to make a conforming amendment to IRC section 7527, relating to reduction of advanced payment of credit for health insurance costs of individuals for amounts received under national emergency grants.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
7527	113-128	512(r)	1712

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5. Public Law 113-188, the Government Reports Elimination Act of 2014, amends the IRC to make a cross-reference change to correspond to changes in Title 29 of the United States Code.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
9502	113-188	1501(b)(2)(D)	2024

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6. Public Law 113-235, Divisions D, H and N, Energy and Water Development and Related Agencies Appropriations Act, 2015, Legislative Branch Appropriations Act, 2015, and Other Matters, respectively, amend the IRC to make amendments to tables, to make cross-reference changes, and to modify the treatment of certain insurance companies.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
7801	113-235	-	2337
7801	113-235	-	2337
9501	113-235	-	2458
7462	113-235	1301(b)	2537
833	113-235	102(a)	2773
833	113-235	102(b)	2773

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7. Public Law 113-287, National Park Service and Related Programs, amends the IRC to make a cross-reference changes to IRC section 9503, relating to the highway trust fund.

IRC Section	Public Law No.	Act Section No.	128 Stat. Page
9503	113-287	5(h)	2024

EXHIBIT B – EXPIRING TAX PROVISIONS

California Sunset[464]	California Section	Federal Section	Federal Sunset	Description
12/31/15	18754 – 18754.3	N/A	N/A	Voluntary Contribution: California Sea Otter Fund
6/30/16	19558	N/A	N/A	Permit the FTB to Disclose Income Tax Return Information to the Public Employees Retirement System Regarding the Early Retiree Reinsurance Program
12/31/16	17053.86 & 23686	N/A	N/A	Credit: College Access Tax Credit
12/31/16	17053.57 & 23657	N/A	N/A	Credit: Community Development Financial Institution Deposits
12/31/17	18416.5	N/A	N/A	Allow Electronic Communication to Taxpayers to Inform of Tax Change
12/31/17	18741 - 18744	N/A	N/A	Voluntary Contribution: Fish and Game Preservation Fund
12/31/17	18791 - 18796	N/A	N/A	Voluntary Contribution: Designations to California Breast Cancer Research Fund
12/31/17	18861 - 18864	N/A	N/A	Voluntary Contribution: California Cancer Research Fund
12/31/17	17053.62 & 23662	45H	Permanent	Credit: Environmental Credit for Production of Ultra Low Sulfur Diesel Fuel
12/31/18	17141	N/A	N/A	Exclusion of Reimbursement for Federal Taxes Imposed on Health Benefits for Same-Sex Spouses and Domestic Partners
12/31/18	19551.5	N/A	N/A	City Business Tax/License Information
12/31/18	18851 - 18855	N/A	N/A	Voluntary Contribution: Emergency Food Assistance Program Fund

[464] In general, this is the last taxable year to which the provision applies. Fiscal years beginning within this taxable year are, in general, also covered by the provision. In some cases, the repeal date of the section is listed or the expiration applies to transactions occurring after this date.

California Sunset	California Section	Federal Section	Federal Sunset	Description
12/31/18	18725 - 18729	N/A	N/A	Voluntary Contribution: California Senior Legislature Fund
12/31/18	17138.2 - 24308.2	N/A	N/A	Exclusion of Rebate Incentives for Expenses of Participating in a Turf Removal Water Conservation Program
12/31/18	18725 - 18729	N/A	N/A	Voluntary Contribution: California Fund for Senior Citizens
12/31/19	18761 - 18766	N/A	N/A	Voluntary Contribution: California Alzheimer's Disease and Related Research Fund
06/30/20	17053.30 - 23630	N/A	N/A	Credit: Natural Heritage Preservation Tax Credit
12/31/20	18801 - 18804	N/A	N/A	Voluntary Contribution: California Firefighter's Memorial Fund
12/31/20	18805 - 18808	N/A	N/A	Voluntary Contribution: California Peace Officer's Memorial Foundation Fund
12/31/20	18900.20 - 18900.26	N/A	N/A	Voluntary Contribution: Habitat for Humanity Fund
12/01/24	17053.73 & 23626	N/A	N/A	New Employment Credit[465]
12/31/24	17059.2 & 23689	N/A	N/A	Credit: California Competes Tax Credit
12/31/24	23636	N/A	N/A	Credit: New Advanced Strategic Aircraft Credit

[465] The new-employment-credit law sections (R&TC sections 17053.73 and 23626) are repealed on December 1, 2024. Those law sections generally apply to taxable years beginning on or after January 1, 2014, and before January 1, 2021; however, they continue to be operative for taxable years beginning on or after January 1, 2021, but only with respect to qualified full-time employees who commence employment with a qualified taxpayer in a designated census tract or former enterprise zone in a taxable year beginning before January 1, 2021.

EXHIBIT C – REVENUE TABLES

Assumed Enactment after June 30, 2015

Table 1 – Philippines Charitable Giving Assistance Act (Public Law 113-92)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
2	Acceleration of Income Tax Benefits for Charitable Cash Contributions for Relief of Victims of Typhoon Haiyan in the Philippines	Expired	Expired	Expired

Table 2 – Cooperative and Small Employer Charity Pension Flexibility Act (Public Law 113-97)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
201 - 203	Funding Rules Applicable to Cooperatives and Small Employer Charity Pension Plans, Definitions, and Elections	Baseline	Baseline	Baseline

Table 3 – Highway and Transportation Funding Act of 2014 (Public Law 113-159)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
2001 - 2002	Extension of Highway Trust Fund Expenditure Authority and Funding of Highway Trust Fund	N/A	N/A	N/A
2003	Funding Stabilization	Baseline	Baseline	Baseline

Table 4 – Tribal General Welfare Exclusion Act of 2014 (Public Law 113-168)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
2 - 4	Indian General Welfare Benefits	Baseline	Baseline	Baseline

Table 5 – Multiemployer Pension Reform Act of 2014 (Division O, Public Law 113-235)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
101	Repeal of Sunset of PPA Funding Rules	Baseline	Baseline	Baseline
102	Election to Be in Critical Status	Baseline	Baseline	Baseline
103	Clarification of Rule for Emergence from Critical Status	Baseline	Baseline	Baseline
104	Endangered Status Not Applicable if No Additional Action is Required	Baseline	Baseline	Baseline
105	Correct Endangered Status Funding Improvement Plan Target Funding Percentage	Baseline	Baseline	Baseline
106	Conforming Endangered Status and Critical Status Rules during Funding Improvement and Rehabilitation Plan Adoption Periods	Baseline	Baseline	Baseline
107	Corrective Plan Schedules When Parties Fail to Adopt in Bargaining	Baseline	Baseline	Baseline
108	Repeal of Reorganization Rules for Multiemployer Plans	Baseline	Baseline	Baseline
109	Disregard of Certain Contribution Increases for Withdrawal Liability Purposes	Baseline	Baseline	Baseline
201	Contributions, Limitations, Distribution and Notice Requirements, and Approval Process for Benefit Suspensions under Multiemployer Plans in Critical and Declining Status	Baseline	Baseline	Baseline

Table 6 – Other Retirement-Related Modifications (Division P, Public Law 113-235)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
2	Clarification of the Normal Retirement Age	Baseline	Baseline	Baseline
3	Application of Cooperative and Small Employer Charity Pension Plan Rules to Certain Charitable Employers Whose Primary Purpose is Providing Services with Respect to Children	Baseline	Baseline	Baseline

Table 7 – An Act to Amend Certain Provisions of the FAA Modernization and Reform Act of 2012 (Public Law 113-243)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
1	Rollover of Amounts Received in Airline Carrier Bankruptcy	Baseline	Baseline	Baseline

Table 8 – Tax Increase Prevention Act of 2014 (Division A of Title I of Public Law 113-92)				
Act Section	**Provision**	**2015-16**	**2016-17**	**2017-18**
101	Extension of Deduction for Certain Expenses of Elementary and Secondary School Teachers	N/A	N/A	N/A
102	Extension of Exclusion from Gross Income of Discharge of Qualified Principal Residence Indebtedness	Expired	Expired	Expired
103	Extension of Parity for Employer-Provided Mass Transit and Parking Benefits	Baseline	Baseline	Baseline
104	Extension of Mortgage Insurance Premiums Treated as Qualified Residence Interest	N/A	N/A	N/A
105	Extension of Deduction of State and Local General Sales Taxes	N/A	N/A	N/A
106	Extension of Special Rule for Contributions of Capital Gain Real Property Made for Conservation Purposes	Expired	Expired	Expired

Act Section	Provision	2015-16	2016-17	2017-18
107	Extension of Above-the-Line Deduction for Qualified Tuition and Related Expenses	N/A	N/A	N/A
108	Extension of Tax-Free Distributions from Individual Retirement Plans for Charitable Purposes	Baseline	Baseline	Baseline
111	Extension of Research Credit	N/A	N/A	N/A
112	Extension of Temporary Minimum Low-Income Housing Tax Credit Rate for Non-Federally Subsidized Buildings	No Impact	No Impact	No Impact
113	Extension of Military Housing Allowance Exclusion for Determining Whether a Tenant in Certain Counties is Low Income	No Impact	No Impact	No Impact
114	Extension of Indian Employment Tax Credit	N/A	N/A	N/A
115	Extension of New Markets Tax Credit	N/A	N/A	N/A
116	Extension of Railroad Track Maintenance Credit	N/A	N/A	N/A
117	Extension of Mine Rescue Team Training Credit	N/A	N/A	N/A
118	Extension of Employer Wage Credit for Employees Who Are Active Duty Members of the Uniformed Services	N/A	N/A	N/A
119	Extension of Work Opportunity Tax Credit	$10,000,000	$2,300,000	$900,000
120	Extension of Qualified New Zone Academy Bonds	N/A	N/A	N/A
121	Extension of Classification of Certain Race Horses as 3-Year Property	Expired	Expired	Expired
122	Extension of 15-Year Straight-Line Cost Recovery for Qualified Leasehold Improvements, Qualified Restaurant Buildings and Improvements, and Qualified Retail Improvements	N/A	N/A	N/A

Act Section	Provision	2015-16	2016-17	2017-18
123	Extension of 7-Year Recovery Period for Motorsports Entertainment Complexes	N/A	N/A	N/A
124	Extension of Accelerated Depreciation for Business Property on an Indian Reservation	N/A	N/A	N/A
125	Extension of Bonus Depreciation	N/A	N/A	N/A
126	Extension of Enhanced Charitable Deduction for Contributions of Food Inventory	N/A	N/A	N/A
127	Extension of Increased Expensing Limitations and Treatment of Certain Real Property as Section 179 Property	N/A	N/A	N/A
128	Extension of Election to Expense Mine Safety Equipment	N/A	N/A	N/A
129	Extension of Special Expensing Rules for Certain Film and Television Productions	N/A	N/A	N/A
130	Extension of Deduction Allowable with Respect to Income Attributable to Domestic Production Activities in Puerto Rico	N/A	N/A	N/A
131	Extension of Modification of Tax Treatment of Certain Payments to Controlling Exempt Organizations	Expired	Expired	Expired
132	Extension of Treatment of Certain Dividends of Regulated Investment Companies	N/A	N/A	N/A
133	Extension of RIC Qualified Investment Entity Treatment Under FIRPTA	N/A	N/A	N/A
134	Extension of Subpart F Exception for Active Financing Income	Baseline	Baseline	Baseline
135	Extension of Look-Thru Treatment of Payments Between Related Controlled Foreign Corporations Under Foreign Personal Holding Company Rules	Baseline	Baseline	Baseline

Act Section	Provision	2015-16	2016-17	2017-18
136	Extension of Temporary Exclusion of 100 Percent of Gain on Certain Small Business Stock	N/A	N/A	N/A
137	Extension of Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property	Expired	Expired	Expired
138	Extension of Reduction in S-Corporation Recognition Period for Built-in Gains Tax	Expired	Expired	Expired
139	Extension of Empowerment Zone Tax Incentives	N/A	N/A	N/A
140	Extension of Temporary Increase in Limit on Cover over of Rum Excise Taxes to Puerto Rico and the Virgin Islands	Defer to the BOE	Defer to the BOE	Defer to the BOE
141	Modification and Extension of American Samoa Economic Development Credit	N/A	N/A	N/A
151	Extension of Credit for Nonbusiness Energy Property	N/A	N/A	N/A
152	Extension of Second Generation Biofuel Producer Credit	N/A	N/A	N/A
153	Extension of Incentives for Biodiesel and Renewable Diesel	N/A	N/A	N/A
154	Extension of Production Credit for Indian Coal Facilities Placed in Service Before 2009	N/A	N/A	N/A
155	Extension and Modification of Credits With Respect to Facilities Producing Energy from Certain Renewable Resources	N/A	N/A	N/A
156	Extension of Credit for Energy-Efficient New Homes	N/A	N/A	N/A
157	Extension of Special Allowance for Second Generation Biofuel Plant Property	N/A	N/A	N/A
158	Extension of Energy Efficient Commercial Buildings Deduction	N/A	N/A	N/A

Act Section	Provision	2015-16	2016-17	2017-18
159	Extension of Special Rule for Sales or Dispositions to Implement FERC or State Electric Restructuring Policy for Qualified Electric Utilities	N/A	N/A	N/A
160	Extension of Tax Credits Relating to Certain Fuels	Defer to the BOE	Defer to the BOE	Defer to the BOE
161	Extension of Credit for Alternative Fuel Vehicle Refueling Property	N/A	N/A	N/A
171	Extension of Automatic Extension of Amortization Periods	Baseline	Baseline	Baseline
172	Extension of Shortfall Funding Method and Endangered and Critical Rules Appliances	Baseline	Baseline	Baseline

Table 9 – Joint Committee on Taxation
(Title III of Division A of Public Law 113-295)

Act Section	Provision	2015-16	2016-17	2017-18
301	Increased Refund and Credit Threshold for Joint Committee on Taxation Review of C Corporation Returns	N/A	N/A	N/A

Table 10 – Achieving a Better Life Experience (ABLE) Act of 2014
(Division B of Public Law 113-295)

Act Section	Provision	2015-16	2016-17	2017-18
102	Qualified ABLE Programs	- $100,000	- $400,000	- $900,000
103	Treatment of ABLE Accounts under Certain Federal Programs	N/A	N/A	N/A
105	Investment Direction Rule for 529 Plans	Negligible	Negligible	Negligible
205	Modification Relating to Inland Water Ways Trust Fund Financing Rate	Defer to the BOE	Defer to the BOE	Defer to the BOE

Act Section	Provision	2015-16	2016-17	2017-18
205	Modification Relating to Inland Water Ways Trust Fund Financing Rate	Defer to the BOE	Defer to the BOE	Defer to the BOE
206	Certified Professional Employer Organizations	Defer to the EDD	Defer to the EDD	Defer to the EDD
207	Exclusion of Dividends from Controlled Foreign Corporations from the Definition of Personal Holding Company Income for Purposes of the Personal Holding Company Rules	Baseline	Baseline	Baseline
208	Inflation Adjustment for Certain Civil Penalties under the Internal Revenue Code of 1986			
	a. Failure to File Tax Return or Pay Tax	$1,200,000	$2,600,000	$3,600,000
	b. Tax Return Preparer's Failure to Furnish Copies to Taxpayers	Negligible	Negligible	Negligible
	c. Failure to File Certain Information Returns, Registration Statements, Etc.	Negligible	Negligible	Negligible
	d. Failure to File Partnership Returns	Negligible	Negligible	Negligible
	e. Failure to File S Corporation Returns	Negligible	Negligible	Negligible
	f. Failure to File Correct Information Returns & Failure to File Correct Payee Statements	Negligible	Negligible	Negligible
209	Increase in Continuous Levy	N/A	N/A	N/A