

SUMMARY ANALYSIS OF AMENDED BILL

Author: Calderon Analyst: Gail Hall Bill Number: AB 692
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: May 4, 2009
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Internal Revenue Code (IRC) Section 382 And Notice 2008-83

- DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended April 4, 2009.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.
- FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO _____.
- REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 4, 2009, STILL APPLIES.
- OTHER – See comments below.

SUMMARY

This bill provides that California will not follow specific federal guidelines related to treatment of statutory deductions for loss items allowed after an ownership change to a bank.

SUMMARY OF AMENDMENTS

The May 4, 2009, amendments made the following changes to the bill:

- Resolved implementation considerations noted in the department’s prior analysis. (See Appendix A)
- Resolved prior technical consideration Nos. 2 and 3. (See Appendix A)
- Added two technical considerations. (Nos. 2 and 3)
- Moved and revised the provisions relating to conformity to any federal regulation, rule, notice, and other interpretations of federal income tax laws.

Board Position:	Legislative Director	Date
<input type="checkbox"/> S <input type="checkbox"/> NA <input type="checkbox"/> NP <input type="checkbox"/> SA <input type="checkbox"/> O <input type="checkbox"/> NAR <input type="checkbox"/> N <input type="checkbox"/> OUA <input checked="" type="checkbox"/> PENDING	Brian Putler	06/08/09

Except for the "EFFECTIVE/OPERATIVE DATE," "THIS BILL," "IMPLEMENTATION CONSIDERATIONS," and "TECHNICAL CONSIDERATIONS," discussion in this analysis, the remainder of the department's analysis of the bill as amended April 2, 2009, still applies. Technical consideration No. 1 discussed in the analysis of the bill as amended April 2, 2009, has not been resolved, and is provided for convenience.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010, and operative as of that date. (See the TECHNICAL CONSIDERATIONS section in this analysis for further discussion)

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would provide the following legislative findings and declarations:

- a. The California Revenue & Taxation Code (R&TC) provides for specified conformity to various referenced provisions of the IRC, as enacted as of a specified date.
- b. For taxable years beginning on or after January 1, 2005, California conforms to those referenced IRC sections, as in effect on the specified date of January 1, 2005 except as otherwise specifically provided.
- c. California conforms to IRC section 382 as enacted as of January 1, 2005.
- d. As enacted as of January 1, 2005, IRC section 382 applied to financial institutions, and section 382 included no specific authority for regulatory actions by the Internal Revenue Service (IRS) or the Department of Treasury to exempt banks or other financial institutions from its provisions.
- e. On September 30, 2008, the IRS issued Notice 2008-83 stating that any deduction properly allowed after an ownership change to a bank with respect to losses on loans or bad debts would not be subject to the IRC 382 limitation.
- f. Notice 2008-83 constitutes a substantive change to IRC section 382 as enacted as of January 1, 2005.
- g. California conforms to IRC section 382 as enacted on January 1, 2005, but the Legislature's action in conforming to IRC section 382 did not contemplate the substantive change in the application of IRC section 382 set forth in Notice 2008-83.

h. On February 17, 2009, President Barack Obama signed the American Recovery and Reinvestment Act (ARRA) of 2009 (Public Law 111-5) which made the following congressional findings:

- The delegation of authority to the Secretary of the Treasury under Section 382(m) of the Internal Revenue Code does not authorize the secretary to provide exemptions or special rules that are restricted to particular industries or classes of taxpayers.
- Notice 2008-83 is inconsistent with the congressional intent in enacting Section 382(m) of the Internal Revenue Code.
- The legal authority to prescribe Notice 2008-83 is doubtful.
- However, as taxpayers should generally be able to rely on guidance issued by the Secretary of the Treasury, legislation is necessary to clarify the force and effect of Notice 2008-83 and restore the proper application under federal "Section 382 limitation" rules following an ownership change.
- ARRA limits the force and effect of Notice 2008-83 to the period beginning with the date the notice was issued and ending on January 16, 2009.
- The congressional findings provide additional confirmation that California did not, and should not, conform to the substantive changes that were attempted to be made by Notice 2008-83.

In addition, the following provisions relating to the application of federal law were added:

1. Federal administrative guidance regarding an interpretation of a provision of the Internal Revenue Code that California conforms to shall apply for California purposes if it does not "conflict with this part" (state law) or with regulations issued by the Franchise Tax Board.
2. "Federal administrative guidance" means federal revenue rulings, notices, revenue procedures, announcements, and other published administrative guidance promulgated by the Commissioner or Chief Counsel of the Internal Revenue Service (IRS). "Federal administrative guidance" does not include a private letter ruling or any other administrative guidance issued by the Commissioner or Chief Counsel of the IRS with respect to a particular taxpayer.
3. Unless otherwise specifically provided, final or temporary federal regulations and any federal administrative guidance shall not apply for state tax law purposes prior to the applicable specified date of conformity to federal law.
4. "Conflict with this part" includes, but not limited to, any temporary or final federal regulation or any federal administrative guidance, except as specifically provided under state law, that constitutes a substantive change in federal law that is inconsistent with the statute or statutes to which such advice relates or is beyond the scope of the Secretary of the Treasury's authority.

The four provisions discussed above would apply to personal income tax law (PITL) and corporation tax law (CTL).

TECHNICAL CONSIDERATIONS

The department has identified the following technical considerations. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

1. On page 2, lines 35 and 36, the legislative finding and declaration provide that Notice 2008-83, references "financial institutions." Notice 2008-83 makes no reference to "financial institutions," therefore, the author may want to revise the legislative findings and declarations and remove the reference to the word "financial institution" and replace it with the term "bank."
2. On page 3, line 31, "Internal Revenue Code Notice 2008-83" should be replaced with "Internal Revenue Service Notice 2008-83."
3. Since Notice 2008-83 was issued in September 2008 and operative retroactively for all open years, the author may want to add specific operative language to the bill to make it clear that its provisions would apply to all taxable periods for which the statute of limitations remains open as of the date of enactment.

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APPENDIX A
Resolved Implementation and Technical Considerations
AB 692 As Amended April 2, 2009

Resolved Implementation Considerations Discussed In The Department's Analysis of The Bill As Amended April 2, 2009:

1. This bill provides that FTB may determine that any federal income tax regulation, rule, notice, or other interpretations of federal income tax laws are inapplicable for California tax law purposes if legal authority is doubtful or automatic conformity to the federal interpretation may infringe on the Legislature's authority to make laws involving significant policy issues. The terms "doubtful legal authority," "automatic conformity," and "may infringe on the Legislature's authority to make laws involving significant policy issues" are not defined.

The lack of definitions and/or standards for key terms presents difficulties in implementing and administering this bill. The terms "doubtful legal authority" and "automatic conformity" may cause confusion to taxpayers and FTB. In addition, it is unclear what the author means by "may infringe on the Legislature's authority to make laws involving significant policy issues." Without further clarity, it would be difficult for FTB to determine when this circumstance occurs.

2. The language in the bill could be interpreted as limiting FTB's authority under existing law to issue a regulation contrary to an otherwise applicable federal regulation to only the circumstances identified.

Resolved Technical Consideration Discussed In The Department's Analysis of The Bill As Amended April 2, 2009:

2. On page 3, lines 37 to 39, the operative date language for paragraph (1) should reference "that paragraph" instead of "that subdivision." In addition, paragraph (1) refers to IRS guidance and regulations, yet the operative date language only refers to guidance. The words "and regulation" should be inserted after guidance.
3. The author should consider amending R&TC sections 17024.5 and 23051.5, which deal with the application of federal IRC provisions including federal regulations instead of R&TC section 19503 that deals with California Code of Regulations. If the amendments remain in R&TC section 19503, the amendments should be included in a separate subdivision.