

BILL ANALYSIS

Analyst: Gail Hall
Work Phone: 845-6111

Department, Board, Or Commission	Author	Bill Number
Franchise Tax Board	Calderon	AB 692

SUBJECT

Conformity: Federal Administrative Guidance

SUMMARY

This bill codifies rules for applying federal administrative guidance for state law purposes.

PURPOSE OF BILL

According to the author's staff the purpose of this bill is to ensure that, in the future, the Legislature's authority to enact laws is not impinged by any federal notice or guidance of doubtful legal authority and to protect California's General Fund from losing revenue.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010, and operative as of that date.

ANALYSIS

FEDERAL/STATE LAW

The Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL), in general, conform to the Internal Revenue Code (IRC) either by reference to federal law as of a "specified date" or by stand-alone language that mirrors the federal provision. Currently, California law is conformed to the IRC as of January 1, 2005, unless a specific provision provides otherwise.¹ In addition, state law provides that where federal and state law are the same temporary and final regulations issued by the Treasury shall apply for California purposes unless the regulations conflict with state law or state regulations.² State statutory law is silent as to the effect of other federal administrative guidance (such as IRS Notices); however, the department has consistently followed such guidance unless there are differences in state and federal law. The State Board of Equalization (BOE) and the courts have also held that federal administrative guidance regarding a federal provision that is applicable for state purposes is very persuasive if not controlling.

FTB Notice 89-277 provides, "Where the provisions of the PITL and the Bank and CTL are in substantial conformity with the IRC, the Franchise Tax Board (FTB) will generally follow federal regulations, procedures and rulings. However, federal rulings and procedures will not be binding on the FTB for California purposes if an authorized officer or employee of the FTB has publicly indicated in writing that the ruling or procedure will not be followed."

¹ Revenue & Taxation Code (R&TC) sections 17024.5 and 23051.5.

² R&TC sections 17024.5(d) and 23051.5(d).

Brian Putler, FTB Contact Person (916) 845-6333 (Office)	Executive Officer Selvi Stanislaus	Date 09/04/09
---	---------------------------------------	------------------

STATUTORY BACKGROUND

In September 2008, the Treasury Department issued Notice 2008-83 (see Appendix A), which provides that any deduction properly allowed after an ownership change to a bank with respect to losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts) will not be treated as a built-in loss or a deduction that is attributable to periods before the change date, and therefore, would not be subject to IRC section 382 limitations.

Controversy Over Notice 2008-83

After Notice 2008-83 was issued by the Treasury Department, numerous articles were published discussing the controversy and issues surrounding issuance of the notice. The following are excerpts from a sample of publications addressing Notice 2008-83:

- Washington Post:³ “The financial world was fixated on Capitol Hill as Congress battled over the Bush administration's request for a \$700 billion bailout of the banking industry. In the midst of this late-September drama, the Treasury Department issued a five-sentence notice that attracted almost no public attention.”

“The sweeping change to two decades of tax policy escaped the notice of lawmakers for several days, as they remained consumed with the controversial bailout bill. When they found out, some legislators were furious. Some congressional staff members have privately concluded that the notice was illegal. But they have worried that saying so publicly could unravel several recent bank mergers made possible by the change and send the economy into an even deeper tailspin.”

“Did the Treasury Department have the authority to do this? I think almost every tax expert would agree that the answer is no,” said George K. Yin, the former chief of staff of the Joint Committee on Taxation, the nonpartisan congressional authority on taxes. “They basically repealed a 22-year-old law that Congress passed as a backdoor way of providing aid to banks.”

- BNA's Tax and Accounting Center:⁴ “Controversy is increasing around embattled Notice 2008-83, the Treasury Department's guidance lifting the limits on the use of losses by banks following acquisitions, with two bills introduced on Capitol Hill to overturn the notice and other legislators considering the issue.”

“Clamor against the notice, originally issued along with a series of other guidance to help struggling banks survive, appears to be intensifying. Senate Finance Committee ranking Republican Charles Grassley (Iowa), who already asked Treasury Inspector General Eric Thorson to investigate the notice, is “still exploring his options,” Grassley spokeswoman Jill Gerber told BNA Nov. 25. “He hasn't ruled out legislation.”

³ Amit R. Paley, “A Quiet Windfall For U.S. Banks,” *Washington Post*, Page A01, November 10, 2008.

⁴ Alison Bennett, “Controversy Over Bank Loss Notice Grows As New Measures Aim to Overturn Guidance,” *BNA's Tax and Accounting Center*, December 1, 2008.

“As questions continue to be raised about Treasury's authority to issue the guidance, which the agency has defended in recent days, the two measures unveiled in recent days would spell differing degrees of trouble for Notice 2008-83.”

The two bills would have taken different approaches. “Both bills—S. 3692, unveiled by Sen. Bernard Sanders (I-Vt.), and H.R. 7300, introduced by House Ways and Means Committee member Rep. Lloyd Doggett (D-Texas)—would overrule Notice 2008-83. Issued Sept. 30, the notice allows banks far greater freedom to use losses under IRC section 382(h) in mergers and acquisitions.”

The American Recovery and Reinvestment Act of 2009 (ARRA), signed into law February 17, 2009, revoked Notice 2008-83. ARRA provides that the Secretary of the Treasury is not authorized under federal law⁵ to provide exemptions or special rules that are restricted to particular industries or classes of taxpayer, and that Notice 2008-83 is inconsistent with the Congressional intent of federal law.⁶ In addition, ARRA provides that although the legal authority to prescribe Notice 2008-83 is doubtful, for taxpayers who have already relied upon its guidance, it is effective only for ownership changes occurring on or before January 16, 2009⁷, except that the guidance is effective for ownership changes occurring after January 16, 2009, that were made under the following circumstances:

- Under a written binding contract entered into on or before January 16, 2009, or
- Under a written agreement entered into on or before January 16, 2009, if the agreement was described on or before that date in a public announcement or in a filing with the Securities Exchange Commission required by reason of the ownership change.⁸

THIS BILL

This bill would add the following provisions relating to conformity to federal law:

1. Federal administrative guidance regarding an interpretation of a provision of the IRC 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 FTB.
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 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.

⁵ IRC section 382(m)

⁶ 2009 ARRA section 1261(a).

⁷ 2009 ARRA section 1261(b)(1).

⁸ 2009 ARRA section 1261(b)(2).

4. "Conflict with this part" includes, but is not limited to, any temporary or final federal regulations 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 PITL and CTL.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate and Discussion

This bill simply codifies the department's current practice for determining if specific federal administrative guidance is applicable to state law, therefore, this bill has no revenue impact.

Appointments

None.

Support/Opposition

The information below is according to the most recent policy committee analysis issued by the Senate Revenue & Taxation Committee.

Support:

California School Employees Association
California Tax Reform Association
American Federation of State, County, and Municipal Employees
California Church IMPACT

Opposition: None received

VOTES

Assembly Floor – Ayes: 51, Noes: 17

Senate Floor – Ayes: 22, Noes: 12

Concurrence – Ayes: 49, Noes: 27

LEGISLATIVE STAFF CONTACT

Gail Hall
Franchise Tax Board
(916) 845-6111
gail.hall@ftb.ca.gov

Brian Putler
Franchise Tax Board
(916) 845-6333
brian.putler@ftb.ca.gov

**APPENDIX A
(IRS NOTICE 2008-83)⁹**

Internal Revenue Bulletin: 2008-42

October 20, 2008

Notice 2008-83

Application of Section 382(h) to Banks

Table of Contents

- SECTION 1. OVERVIEW
- SECTION 2. TREATMENT OF DEDUCTIONS UNDER SECTION 382(h)
- SECTION 3. RELIANCE ON NOTICE
- SECTION 4. SCOPE

SECTION 1. OVERVIEW

The Internal Revenue Service and Treasury Department are studying the proper treatment under section 382(h) of the Internal Revenue Code (Code) of certain items of deduction or loss allowed after an ownership change to a corporation that is a bank (as defined in section 581) both immediately before and after the change date (as defined in section 382(j)). As described below under the heading Reliance on Notice, such banks may rely upon this guidance unless and until there is additional guidance.

SECTION 2. TREATMENT OF DEDUCTIONS UNDER SECTION 382(h)

For purposes of section 382(h), any deduction properly allowed after an ownership change (as defined in section 382(g)) to a bank with respect to losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts) shall not be treated as a built-in loss or a deduction that is attributable to periods before the change date.

SECTION 3. RELIANCE ON NOTICE

Corporations described in section 1 of this notice may rely on the treatment set forth in this notice, unless and until there is additional guidance.

SECTION 4. SCOPE

This notice does not address the application of any provision of the Code other than section 382.

The principal author of this notice is Mark S. Jennings of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice, contact Mark S. Jennings at (202) 622-7750 (not a toll-free call).

⁹ http://www.irs.gov/irb/2008-42_IRB/ar08.html