State of California
Franchise Tax Board

SUMMARY OF FEDERAL INCOME TAX CHANGES — 1988

Laws Affected
Personal Income Tax
Bank & Corporation Tax

This report is submitted in fulfillment of the requirement in Revenue and Taxation Code Section 19270.

SUMMARY OF

FEDERAL INCOME TAX CHANGES

1988

Prepared by Staff of the

FRANCHISE TAX BOARD

State of California

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FEDERAL INCOME TAX CHANGES - 1988

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Executive Summary

In 1988 the President signed into law several Acts which make changes to the Internal Revenue Code. The majority of the changes are contained in the Technical and Miscellaneous Revenue Act (TAMRA) which provides for necessary technical corrections and clean up to legislation enacted in prior years (primarily the Tax Reform Act of 1986). TAMRA also provides for the extension of several expiring tax provisions as well as changes which raise revenue to help offset the cost of those extensions. In addition, TAMRA enacted the Taxpayer Bill of Rights which provides protection to taxpayers in their contacts with the Internal Revenue Service.

Four changes were made to the Internal Revenue Code by the Family Support Act. Those changes extend the tax refund offset program, tighten the rules for deducting employee business expenses which are reimbursed, reduce the amount allowed under the Child Care Credit and require the reporting of dependent children's social security numbers at the age of 2 instead of at age 5.

The remaining 1988 changes include the repeal of the Windfall Profits Tax, provide exclusions from income for reparation payments under the Wartime Relocation of Civilians legislation, authorize IRS undercover operations under the Anti-Drug Abuse Act and provide appropriations or require certain studies to be made by the Secretary of the Treasury.

PART I

FAMILY SUPPORT ACT
(P.L. 100-485, Signed October 13, 1988)

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Summary

This report is limited to a discussion of only the four sections in the Family Support Act which make changes to the Internal Revenue Code for the express purpose of providing the funding source for that legislation. These changes extend the tax refund offset program, tighten the rules for deducting employee business expenses which are reimbursed, reduce the amount allowed under the Child Care Credit and require the reporting of dependent children's Social Security numbers at the age of 2 instead of at age 5.

TITLE VII: Funding Provisions

ACTION: EXTENDS THE TERMINATION DATE OF THE TAX REFUND OFFSET PROGRAM

Act Section 701

BACKGROUND

Under federal law, federal agencies are authorized to notify the Internal Revenue Service of any taxpayer who owes a past-due, legally enforceable debt to the agency. Any taxpayer who has overpaid his/her tax liability and owes a legally enforceable obligation to any federal agency will forfeit their refund in lieu of payment for that obligation.

Upon receipt of a written request, the Internal Revenue Service can disclose to officers and employees of federal agencies certain information with respect to the taxpayer. This information can only be used for the purpose of establishing appropriate agency records.

Currently, upon notification, the agency in which the debt is owed must provide supporting evidence to the Internal Revenue Service that the taxpayer has been notified about the proposed offset. Also, the taxpayer must have been given at least 60 days to present evidence that the debt is not legally due.

The tax refund offset program was scheduled to expire on June 30, 1988. The new provision extends the offset program to help facilitate the collection of debts owed to a federal agency which are uncollectible.

CURRENT CALIFORNIA LAW (Government Code Sec. 12419.2 thru 12419.9)

California has a similar provision which allows the Controller's Office, until December 31, 1990, to offset delinquent accounts against income tax refunds which have been certified by the Franchise Tax Board in the following priority:

1. The nonpayment of child support;

2. Benefit overpayment accounts administered by the Employment Development Department;

3. Other offset accounts in the priority determined by the Controller.

Also the Controller may, in his discretion, offset any amount due a state agency or a county from a person or entity, against any amount owed to such person or entity by the Franchise Tax Board. The Controller may deduct from the claim, and draw his warrants for the amounts offset in favor of the respective agencies to which due, and, for any balance, in favor of the claimant. Whenever insufficient to offset all amounts due, the amount available shall be applied in such manner as the Controller, in his discretion, shall determine.

NEW FEDERAL LAW (Sec. 6103(1)(10))

The new federal provision extends the termination date of the tax offset program. The offset program is extended for tax refunds payable before January 10, 1994.

Also, because the provision's termination date was June 30, 1988 and the extension did not occur until October 13, 1988, Congress states that any offsets during this time will not be effected by the termination of the federal law.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to taxable years beginning after October 13, 1988.

STATE REVENUE IMPACT

Not applicable. California's offset provisions have been independently and uniquely designed to facilitate collection of debts.

TITLE VII: Funding Provisions

ACTION: LIMITS THE USE OF REIMBURSEMENT ARRANGEMENTS TO AVOID THE TWO PERCENT FLOOR

Act Section 702

BACKGROUND

Under the Tax Reform Act of 1986, employee business expenses, other than reimbursed expenses, are allowed only as miscellaneous itemized deductions. Miscellaneous itemized deductions are deductible only to the extent that they exceed two percent of the taxpayer's adjusted gross income. However, the floor does not apply to deductions that are allowable for impairment-related work expense for handicapped employees.

The Tax Reform Act also provided that employees reimbursed from their employers for business related expenses may deduct the expense ("above-the-line") from their gross income to the extent of their reimbursement. In addition, Congress required the Treasury Department to issue regulations which allow the treatment of reimbursements by third parties to be treated the same as reimbursements by employers.

Congress enacted a new provision relating to reimbursements by third parties to clarify and support the Treasury Regulations required in the 1986 Tax Reform Act.

CURRENT CALIFORNIA LAW (Sec. 17072)

California is generally in conformity with federal law.

NEW FEDERAL LAW (Sec. 62(a)(2)(A))

The new provision codifies the Treasury Regulations prescribed under the Tax Reform Act of 1986, which applies to third-party reimbursements. Under the provision, an employee who is reimbursed by his or her employer or a third party for business related expenses is allowed a deduction from gross income. The "above-the-line" deduction for reimbursed costs are allowed only if they are incurred under a reimbursement or other expense allowance arrangement that requires the employee to substantiate covered expenditures to the party providing the reimbursement. Also, the reimbursement plan must require the employee to return any excess amount to the employer.

Employee business expenses which exceed reimbursed amounts must be claimed as miscellaneous itemized deductions, which are subject to the two percent floor.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to taxable years beginning after December 31, 1988.

STATE REVENUE IMPACT

Based on national estimates developed for this provision, state revenue gains under the Personal Income Tax Law would be in the $3.5 million range annually.

TITLE VII: Funding Provisions

ACTION: MODIFIES THE REQUIREMENTS FOR CHILD AND DEPENDENT CARE CREDIT

Act Section 703

BACKGROUND

Under current law an individual taxpayer who maintains a household for one or more qualifying dependents may claim a nonrefundable credit for expenses paid for care of these dependents necessary to enable the taxpayer to be employed.

A qualifying dependent is defined as:

1. Any dependent under the age of 15, or

2. A dependent or a spouse who is physically or mentally unable to care for him or herself.

The credit equals the applicable percentage times the employment related expenses paid. The applicable percentage ranges from 20 to 30 percent depending on the taxpayer's adjusted gross income. The applicable percentage is reduced by one percentage point for each $2,000 by which the taxpayer's adjusted gross income exceeds $10,000 but cannot be reduced below 20 percent. Regardless of the amount actually paid, the maximum amount of qualifying expenses that may be claimed in computing the credit is $2,400 for one qualifying individual or $4,800 for two or more qualifying individuals.

Congress enacted this provision originally in order to offer taxpayers some tax benefit for remaining gainfully employed while providing care for their dependents.

CURRENT CALIFORNIA LAW (Sec. 17052.6)

California generally conforms with the federal provisions relating to child and dependent care credit. However, for 1987 through 1992 the amount of the California credit is 30 percent of the allowable federal credit regardless of whether there is a federal tax liability. Also, unlike federal law, which has no repeal date, the California provision is repealed effective January 1, 1993.

NEW FEDERAL LAW (Sec. 21)

The new federal provision contains a variety of modification to the child and dependent care credit. The modifications include:

1. Reducing the eligible age of a qualifying individual from the age of 15 to the age of 13.

2. Limiting the expenses eligible for a credit. The dollar amount of expenses eligible for the credit must be reduced, dollar for dollar, by the amount of dependent care expenses excluded from the taxpayer's adjusted gross income under a dependent care assistance plan maintained by the employer.

3. Reporting the care provider's taxpayer identification number. The credit may not be claimed unless the taxpayer reports on his or her income tax return the correct name, address, and the taxpayer identification number of the care provider. Only the name and address must be reported if the care facility is exempt from federal income tax.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to amounts claimed in taxable years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Based on federal estimates developed for the nation, state revenue gains under the Personal Income Tax Law would be in the $7 million range annually.

TITLE VII: Funding Provisions

ACTION: CHANGES THE REQUIRED AGE FOR DEPENDENT CHILDREN TO OBTAIN A SOCIAL SECURITY NUMBER

Act Section 704

BACKGROUND

The Tax Reform Act of 1986 enacted a provision under which taxpayers claiming a dependent on their income tax return must report the taxpayer identification number (TIN) of that dependent.

That provision established requirements that any taxpayer claiming a dependent, who is at least five years old at the close of the taxable year, must report the taxpayer identification number of such dependent. A penalty of $5 is assessable for failure to provide the dependent's TIN.

CURRENT CALIFORNIA LAW (Sec. 18685.07 and 18934)

California is conformed with federal law as to the requirement, but does not impose a penalty for failure to comply. Because there is no penalty, the tax forms and instructions do not request disclosure of the dependent's TIN.

NEW FEDERAL LAW (Sec. 6109(e)(2))

The new provision reduces the age requirement and now requires the taxpayer to report the dependent's identification number if the dependent becomes age two by the close of the tax year.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is applicable to returns due after December 31, 1989. The effective date was delayed so that taxpayers may apply and receive the identification numbers for their dependent(s) before the returns are due.

STATE REVENUE IMPACT

To the extent taxpayers claim fewer state exemption credits because they fail to provide social security numbers for federal purposes, state revenues will increase by an unknown but most likely minor amount.

PART II

TECHNICAL AND MISCELLANEOUS REVENUE ACT (TAMRA)
(P.L. 100-647, Signed November 10, 1988)

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Summary

After two years of work in Congress, the Technical and Miscellaneous Revenue Act (TAMRA) was signed into law by the President on November 10, 1988. This report focuses on the more substantive provisions of TAMRA contained in Titles III through VI of that Act. Those titles contain provisions to simplify and clarify the Internal Revenue Code (IRC), enact a Taxpayer Bill of Rights, extend and modify certain expiring tax provisions, provide revenue increases as the funding source for the legislation and other provisions which have a substantial revenue impact.

By far, the greatest volume of the changes to the IRC can best be described as clean up to previously enacted legislation including the Tax Reform Acts of 1984 and 1986 as well as Revenue Acts of 1986 and 1987. These technical or clean up changes are generally effective retroactively to the date the original legislation to which they relate went into effect. A brief explanation of these clean up changes is provided in Appendix II of this report.

Titles VII through X of TAMRA are not discussed in this report since the changes contained in those titles have no counterparts in the Revenue and Taxation Code provisions administered by the Franchise Tax Board. Those titles concern changes in the Railroad Unemployment and Retirement programs, amendments to Social Security programs, Trade provisions and those relating to the acquisition of the Manassas National Battlefield Park.

TITLE III: Additional Simplification and Clarification Provisions

SUBTITLE A: Diesel Fuel Excise Tax Collection and Exemption Procedures

ACTION: MODIFIES EXEMPTION FROM EXCISE TAX ON DIESEL AND AVIATION FUELS AND PRESCRIBES INFORMATION RETURN REPORTING

Act Section 3001

BACKGROUND

Federal law imposes an excise tax on the sale of diesel and jet fuel. Prior to TAMRA the tax was collected by the producer or importer while the consumer was required to file for a refund on fuel used for exempt purposes.

TAMRA reduces the burden on consumers by granting the exemption from the tax to an expanded number of consumers.

To curb the potential for increased tax evasion arising from expanding the number of persons qualifying for exempt sales on diesel fuel, the list of information returns and payee statements required is expanded to include information relating to reporting with respect to tax on diesel and aviation fuels. The penalties generally applicable to information returns also apply to the information returns the new law requires.

CURRENT CALIFORNIA LAW

The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not contain any excise taxes on diesel or jet fuel.

NEW FEDERAL LAW (Sec. 4092, 4093, 6427 and 6724(d))

The new provision gives the Internal Revenue Service authority to require information reporting as part of the expansion of the tax fee sale procedures for nontaxable uses of diesel and aviation fuels by purchasers. If the producer, importer or purchaser fails to provide the information required, he/she is subject to a penalty of $50 for failure to file an information return. Also, producers or importers may be subject to a $50 penalty for each failure to furnish a payee statement to each purchaser as required by federal law.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for diesel fuel and non-gasoline aviation fuels sold after January 1, 1989.

STATE REVENUE IMPACT

Not applicable.

TITLE III: Additional Simplification and Clarification Provisions

SUBTITLE A: Diesel Fuel Excise Tax Collection and Exemption Procedures

ACTION: PENALTY FOR FAILURE TO REGISTER OR FALSE STATEMENT NOW APPLIES TO MANUFACTURERS OR PRODUCERS OF DIESEL FUEL AND AVIATION FUEL

Act Section 3001(b)

BACKGROUND

Under federal law, any person who fails to register or who in connection with any purchase of gasoline, lubricating oil, or aviation fuel falsely represents himself to be registered, or who willfully makes any false statement in an application for registration, shall, if convicted thereof, be fined not more than $5,000, or imprisoned not more than 5 years, or both.

A new provision gives the Internal Revenue Service authority to issue regulations prescribing expanded information reporting requirements for both sellers and exempt purchasers of diesel fuel and aviation fuel in order to limit the possibility of increased tax evasion due to the expanded number of buyers qualifying for exempt sales. The above penalty is expanded to include purchases of diesel fuel and aviation fuel.

CURRENT CALIFORNIA LAW

The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board contain no provision imposing an excise tax on diesel fuel or aviation fuel.

NEW FEDERAL LAW (Sec. 7232)

Unless otherwise provided by regulations, both the seller and purchaser of diesel and nongasoline aviation fuel must be registered and the purchaser's registration number must be given to the seller. The new provision requires the Internal Revenue Service to prescribe procedures for complying with the registration requirements within 30 days of enactment. The penalty for failure to register, representing oneself as registered in connection with a purchase of gasoline or lubricating oil, or willfully making a false statement on an application for registration now also applies to diesel fuel and aviation fuel.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for diesel fuel and nongasoline aviation fuel sold after January 1, 1989.

STATE REVENUE IMPACT

Not applicable.

TITLE III: Additional Simplification and Clarification Provisions

SUBTITLE A: Diesel Fuel Excise Tax

ACTION: EXPANDS THE DEFINITION OF EXEMPT USERS AND ALLOWS EXEMPT USERS TO CLAIM AN EXPEDITED REFUND

Act Section 3002

BACKGROUND

Prior to the Omnibus Budget Reconciliation Act of 1987, excise tax on diesel fuel and non-gasoline aviation fuel was generally imposed at the retail level. Benefits of exemption from the excise tax on these fuels were allowed through credits and refunds. Exempt users could either claim a credit against income tax or other excise tax liability, or file a claim for refund. In order to file a claim for refund, the user must have a refundable amount of at least $1,000 during any one of the first three calendar quarters of a year.

Congress determined that the rules with respect to administration of excise tax should be modified in order to lessen the administrative burden on exempt users.

CURRENT CALIFORNIA LAW

The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board contain no provision imposing an excise tax on diesel fuel or aviation fuel.

NEW FEDERAL LAW (Sec. 6427(i))

The new provision extends the tax-free sale procedures for diesel and non-gasoline aviation fuels available for trains, commercial airlines, and State and local governments, to all exempt users in off-highway business uses, including farm use and liberalizes the refund requirements by reducing the threshold for claims. The new law also extends the tax-free purchase rule to private buses currently eligible for a full refund or partial refund of the diesel fuel tax.

In order to maintain the greatest possible compliance, Congress decided that sales to an exempt user may be made without payment of tax only when the parties to the sale satisfy Treasury prescribed bonding and registration requirements. Also, only sales that are direct from a producer (including a wholesale distributor) to the exempt user will qualify under these rules.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is applicable to fuels used after December 31, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE III: Additional Simplification and Clarification Provisions

SUBTITLE B: Health Care Continuation Rules

ACTION: ESTABLISHES AN EXCISE TAX TO REPLACE THE SANCTIONS IMPOSED AGAINST GROUP PLANS WHICH FAIL TO SATISFY CONTINUATION RULES

Act Section 3011

BACKGROUND

This act section amends the Internal Revenue Code for the purpose of reducing the gaps and deficiencies in the health care coverage made available for purchase by the beneficiaries of certain former employees upon retirement and the happening of certain other events which would otherwise cause the coverage to lapse. This section of the act replaces the sanctions currently imposed by federal law with an excise tax on group health plans which are in violation of the continued coverage rules. California law does not normally impose excise taxes. The new monetary penalties at the federal level, which may be levied on employers and group health plans which fail to meet continuation rules may be sufficient to regulate this issue without the existence of additional sanctions at the state level.

CURRENT CALIFORNIA LAW (Sec. 17201, 17270 and 24343)

In most cases, California law conforms to the federal law relating to deductions for trade and business expenses. Employers with 20 or more employees are subject to a continued health coverage requirement. Currently, the cost of a group health care coverage plan which does not satisfy the requirements of providing continued coverage for beneficiaries at the time of certain events does not qualify as a business or trade expense which may be deducted from an employer's gross income.

To satisfy the continued health coverage rules the plan must offer each qualified beneficiary, who would lose coverage as the result of a certain event, an option to purchase continuous coverage under the plan's provisions for up to 36 months of coverage.

The term "continuous coverage" means coverage which is identical to the benefits provided similarly situated beneficiaries under the terms of the plan when a qualified event has not occurred.

"Qualified events" include: death of the covered employee; termination of the employee not due to misconduct; divorce of the employee from a spouse; an employee becoming eligible for Title XVIII Social Security benefits; an employee's child ceasing to be a dependent under the terms of the plan; or the filing of Chapter 11 bankruptcy by the employer of a retired employee.

NEW FEDERAL LAW (Sec. 106, 162, 414 and 4980B)

Section 162(i) which disallows the business and trade expense deduction for the cost of a group health plan which does not satisfy continuous coverage requirements is repealed.

Section 4980B is added to the Internal Revenue Code which establishes an excise tax imposed at the rate of $100 per day for each beneficiary, on employers or plan administrators who are responsible for a failure to satisfy the health care continuous coverage rules. The excise tax is assessed for the period of noncompliance, which begins on the date that continuous coverage rules are not met and ends on the date the failure to meet the rules is corrected, or 6 months after the last date on which the employer could have been required to provide continuous coverage to the qualified beneficiary. If it can be established that none of the responsible parties knew or should have known about the failure to satisfy the coverage rules, then the period of noncompliance does not begin until one of the parties becomes aware of the deficiency in the coverage (inadvertent failure rule).

The annual amount of excise tax which may be imposed for any tax year is the lesser of 10 percent of the cost paid for the group health plan by the employer during the preceding year or $500,000. The annual cap on the excise tax imposed does not apply, if the failure to meet the continuous coverage rules is due to willful neglect. If the failure to meet the rules is due to reasonable cause, and is corrected within 30 days, the excise tax does not apply.

Clerical amendments are also made to sections impacted by this change.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This section of the act is effective and the excise tax applies for tax years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

The excise tax would not be an applicable confority issue at the state level. However, to the extent employers report additional deductions due to improved compliance with continuous coverage requirements, there would be an unknown, but probably minor baseline revenue loss.

TITLE III: Additional Simplification And Clarification Provisions

SUBTITLE C: Employee Benefit Nondiscrimination Rules

ACTION: MODIFIES NONDISCRIMINATION RULES APPLICABLE TO CERTAIN EMPLOYEE BENEFIT PLANS

Act Section 3021

BACKGROUND

As part of the Tax Reform Act of 1986, Congress enacted IRC Section 89, providing nondiscrimination rules for employee fringe benefits, which will go into effect beginning January 1, 1989. Congress's aim in enacting these rules is to prevent employers from maintaining health and life insurance plans as a vehicle for providing tax deferred income to highly compensated employees (including the owner or general managing partner). The law is complicated and consequently, the topic of employee fringe benefits has generated increased interest recently as a tax and revenue issue at the federal level. Clearly, Section 89 marks a major step in the use of tax incentives (or the threat of denying incentives) to promote the equitable apportionment of fringe benefits among all employees.

An additional factor in these developments in federal legislation is that TAMRA changed many important parts of Section 89, resolving questions raised about the original version, even before the section's provisions became effective.

TAMRA directed the IRS to provide guiding regulations relating to Section 89 provisions. However, none have been made available to date. Until the remaining questions regarding Section 89 provisions are resolved, the Conference Committee for TAMRA advises employers to make a "good faith" compliance effort, following a reasonable interpretation of the law and its legislative history.

CURRENT CALIFORNIA LAW (Sec. 17081)

California law is in complete conformity with the nondiscrimination rules established for employee benefit plans by the enactment of Section 89 as part of the Tax Reform Act of 1986.

An employee is considered highly compensated, during the benefit plan's test year or the preceding test year if the employee:

1. owns 5% of the employing company at any time,

2. received more than $75,000 compensation from the employer,

3. earned more than $50,000 and was in the top 20% of the employing company's payroll structure, or

4. was an officer of the employing company and earned more than $45,000.

If an employing company has business operations in two or more locations, the employing company may use a simpler measurement to determine which employees are highly compensated. An employing company may treat any employee who earns more than $50,000 as highly compensated, without regard to whether the employee is in the top 20% of the company's pay scale.

In order to be considered nondiscriminatory in light of Section 89, a plan must satisfy one of two test patterns during its test year. Under the first pattern, a plan must pass four tests:

1. The 50% Eligibility Test - At least one-half of the employees eligible to participate in a plan must be non-highly compensated employees. A substitute for this test is provided which requires that the percentage of all of a business's non-highly compensated employees who are eligible to participate in the plan be equal to the percentage of all the highly compensated employees who are eligible to participate in the plan.

2. The 90%/50% Test - A plan meets this test when at least 90% of a company's non-highly compensated employees are eligible to participate in the plan, and those non-highly compensated employees of a company are eligible to receive a benefit which is at least one-half the value of the most valuable benefit available to highly compensated employees under all similar plans. An employer may aggregate all similar plans when applying the 90%/50% test.

3. The 75% Benefits Test - A plan meets this test when the average value of benefits received by a company's non-highly compensated employees who participate in plans of a similar type is at least 75% of the average value of benefits available to highly compensated employees under similar plans. The average value of benefits is determined by dividing the total value of all benefits received by non-highly and highly compensated employees by the total number of a company's employees, including employees who are not covered by a plan. An employer has the option of mixing different types of plans (i.e. group-term life insurance with dependent care assistance program) to meet the 75% benefits test. However, if a health plan is aggregated with different types of benefit plans, the health plan must meet the 75% benefits test separately, and the aggregation of similar plans (i.e. group-term life insurance with group-term life insurance) is mandatory.

4. The General Nondiscrimination Test - This test is a facts-and-circumstances test which moves away from strictly quantitative measurements, and simply prohibits a plan from containing any eligibility provision which by "its terms or otherwise" discriminates in favor of highly compensated employees.

Under the second test pattern the complicated mathematical measurements of the first pattern are avoided by providing a safe harbor. This safe harbor requires that an employer maintaining a group-term life insurance or a health plan must provide active coverage (not merely eligibility) for 80% of the employer's non-highly compensated employees. In that case, a plan's structure must meet only one other target, the general nondiscrimination test discussed above.

The rules relating to the safe harbor (also called the 80% eligibility test) limit an employer's options to aggregate plans. For example, a group of health plans may be pooled only if the difference between the value of the smallest and largest benefits provided by the plans does not exceed ten percent. However, health plans, with a maximum difference between the most valuable and least valuable benefits of 20%, may be pooled if the employer extends coverage to 90% of the company's non-highly compensated employees. Health plans may also be pooled if they are available to all employees on the same terms, and there is no more than a $100 difference between the lowest and highest premiums paid by employees for those benefits.

The following classes of employees do not have to be provided nondiscriminatory benefits, and are not considered when the nondiscrimination tests are applied to benefit plans:

1. Employees who have not worked for the employing company for at least one year (six months employment when considering certain health plans).

2. Part-time employees who normally work less than 17 1/2 hours per week.

3. Seasonal employees who normally do not work more than six months during a year.

4. Employees who are under 21 years of age.

5. Employees who are included in a collective bargaining agreement.

6. Nonresident alien employees who earn income which is not considered U.S. source income.

7. Students who are employed by a school and receive certain health benefits.

When applying the 80% actual coverage safe harbor test, an employer, who has fewer than 10 employees, may exclude from consideration employees who work less than 35 hours per week. Beginning in 1990, the exclusion from testing consideration is limited to employees working less than 25 hours per week.

Employee exclusions must be consistent for all plans of the same type. If one employee from an excluded group participates in a plan, all employees in the group must be considered for testing purposes. This does not apply in the case of a nonresident alien. Employers, however, may design special plans solely for employees who are excluded from consideration in nondiscrimination tests.

If a highly compensated employee's benefits are determined to be provided on a discriminatory basis, then the value of the discriminatory benefits must be included in the taxable income of the employee on the W-2 reported by the employer. The complexity of the methods for valuation of discriminatory benefits, and the administrative problems faced by the discriminatory employer may, in themselves, be incentives for Section 89 compliance.

While the nondiscrimination testing procedures related to employee fringe benefits have generated the most controversy, failure to meet these tests results only in the taxation of benefits to some highly compensated employees. Failure to meet the following plan qualification requirements of Section 89(k) however, results in the taxation of benefits received by all employees:

1. the plan must be in writing;

2. the employee's rights under the plan's provisions must be legally enforceable;

3. employees must be notified of the benefits available;

4. the plan must be maintained for the exclusive benefit of employees;

5. the plan must be established for an indefinite period of time.

NEW FEDERAL LAW (Sec. 89)

The most important changes to Section 89 made by TAMRA clarify when employers must test fringe benefit plans. TAMRA does not require that a plan pass nondiscrimination tests on every single day of the plan year. Instead, a plan must be assigned a test year, and pass the nondiscrimination tests on a date (test date) prescribed for the year.

A plan's test year is a twelve-month period beginning on the first day of a month designated in the plan. The calendar year is the test year if no designation is made in the plan. An employer must use the same testing period for all plans of the same type.

The testing day must also be designated in a plan and must be the same for all similar plans maintained by the employer. The last day of the testing year will be the testing day, if no designation is made. A plan's testing day and year may be changed only with IRS approval. If multiple employers sponsor a plan, each employer may select its own testing year and day. Any change in a plan's testing day or year may not result in any period being disregarded for purposes of Section 89 testing.

TAMRA permits employers to test plans by using a random sampling of employees, as an alternative to including all employees and benefits in the testing process. The random testing must be done by an independent tester, and the statistical methodology must result in a 95% probability that the test findings will have a margin of error no higher than 3%.

The test must include the value of benefits provided all employees who work for the company on the testing day, computed for the entire testing year, even though the employee only worked for the company for part of the testing year. This may be an important consideration when an employer designates a testing day.

TAMRA gives the IRS regulatory authority to combine the benefits received by an employee who participates in more than one health plan. As a result, plans which ordinarily would pass the 50% eligibility test may fail because, if separate plans are provided for highly compensated employees in addition to health plans available for all employees, no pooling of these plans is allowed for the purpose of meeting the eligibility test requirements.

Under prior law, a benefit provided to a highly compensated employee (and taxable because a plan fails to pass the nondiscrimination tests) was required to be included in that employee's gross income for the year in which the testing year of the benefits plan ends. Under TAMRA, if the testing year ends between September 30 and December 31, an employer may elect to report the taxed benefit in the highly compensated employee's gross income for the next year. However, if the taxation of the excess benefit is deferred, the employer's business expense deduction for the excess benefit must correspondingly be deferred.

TAMRA also provides important guidelines for apportioning the overall discriminatory benefits of all highly compensated employees when employees work during only part of a plan's test year or receive different levels of coverage.

TAMRA allows employers to elect to test plans in one line of business separately from plans in other lines of business, just as if the separate lines of business were separate employers. Separate testing is also permitted for employees who work in units which are 35 miles apart from other operating units in the same line of business.

TAMRA defines a separate line of business as a business operated separately for "bona fide business purposes". Separate lines of business should produce different products or perform different services. A business must have at least 50 employees includable in the nondiscrimination tests, and must notify and receive approval from the IRS to conduct separate testing.

The Conference Committee Report to TAMRA clarifies that the written plan qualification requirement (Section 89(k)) is satisfied either by a single, all-inclusive stand-alone document or by a collection of separate documents.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The effective date of the new provisions is January 1, 1989.

STATE REVENUE IMPACT

Based on the low level of revenue losses estimated for the nation, state revenue losses would be very minor annually, less than $100,000.

TITLE III: Additional Simplification and Clarification Provisions

SUBTITLE D: Estate and Gift Taxes

ACTION: ESTATE TAX VALUATION FREEZES

Act Section 3031

BACKGROUND

Federal law imposes estate and gift taxes based on the value of the decedent's assets or on the transfer before death of assets based on the fair market value of the gifted property. In certain situations persons have transferred appreciated assets before death while retaining specified interests during their lifetime. The federal estate and gift tax will apply to the value at the time the transfer was made (calculated as though the transferor had died) if the transferor retained a disproportionate share of income or rights in the enterprise.

CURRENT CALIFORNIA LAW (Sec. 17024.5)

California specifically makes the rules relating to federal estate and gift taxes not apply for purposes of state income taxation.

NEW FEDERAL LAW (Sec. 2036)

The Act expands the scope of the prior law rules to apply to when any income or rights interest in an enterprise is retained by the transferor. Gift tax provisions are coordinated and safe harbor rules are provided.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Generally these changes are effective for decedents dying after December 31, 1987 but only with respect to property transferred after December 31, 1987.

STATE REVENUE IMPACT

Not applicable.

TITLE III: Additional Simplification and Classification Provisions

SUBTITLE E: Indian Fishing Rights

ACTION: EXEMPTS FROM FEDERAL AND STATE TAXES INCOME DERIVED BY INDIAN TRIBES AND THEIR MEMBERS FROM PROTECTED FISHING ACTIVITIES

Act Sections 3041 thru 3044

BACKGROUND

Various treaties, federal statutes, and executive orders reserve to Indian tribes (mostly in the West and Great Lakes regions) rights to fish for subsistence and commercial purposes both on and off reservations. Because the treaties, statutes, and executive orders were adopted before passage of the federal income tax, they do not expressly provide whether income derived by Indians from protected fishing activities is exempt from taxation.

Indians generally are subject to federal tax in the same manner as other U.S. citizens, absent a federal exemption. The Tax Court has ruled in three cases that income derived by Indians from protected fishing activities is taxable and the IRS has assessed deficiencies in other cases.

CURRENT CALIFORNIA LAW

Gross income is broadly defined to include income derived from any source whatever, except as otherwise specifically provided by statute. California law incorporates the federal definition of gross income by reference. This means that the same items are included in gross income under both laws, unless a specific exclusion or exception is provided. In addition, California can not tax income which the State is prohibited from taxing under the Federal Constitution or federal laws or under the State constitution or state laws.

On June 14, 1976, the U.S. Supreme Court, in Bryan v. Itasca County, 426 U.S. 373, 44 Law Week 4832, concluded that Congress has not conferred to the states taxing jurisdiction as to Indians residing on reservations, and that, in the absence of such congressional consent, federal laws preempt state laws. Accordingly, income received by reservation Indians from reservation sources is exempt from California personal income taxation. Indians living, working, or deriving income from sources outside their reservation are subject to the state income tax laws. If the income is earned both on and off the reservation, it must be allocated, along with applicable costs, to within and without the reservation. Reservation source income of reservation Indians is not considered community property for income tax purposes. All other income accruing to the Indian/non-Indian couple is taxable without regard to its character as separate or community property.

NEW FEDERAL LAW (Sec. 7873)

Act Section 3041(a) provides that income derived by individual members of an Indian tribe, or by a qualified Indian entity, from protected fishing activities (fishing rights-related activities) is exempt from federal taxation (income, social security and unemployment compensation insurance taxes). Fishing rights-related activities are any activity directly related to harvesting, processing, or transporting fish harvested in the exercise of a recognized fishing right of such tribe or to the selling of such fish but only if substantially all of such harvesting was performed by members of the tribe. The exemption from tax applies to direct income received by a taxpayer as well as to distributions with respect to an equity interest in a qualified Indian entity to the extent the distribution is attributable to income derived by the entity from fishing rights-related activities. Both individual tribal members and qualified Indian entities are required to allocate income and expenses among fishing rights-related activities and all other activities. However, allocations are not required where all but a de minimis amount of the income of the individual or entity was derived from protected fishing activities.

A qualified Indian entity is any entity in which (1) all of the equity interests are owned by tribal members (ownership of interests by spouses of tribal members is treated as ownership by tribal members); (2) substantially all of the management functions are performed by tribal members; and (3) if the entity engages in substantial processing or transporting of fish, at least 90 percent of the annual gross receipts are derived from the exercise of protected fishing rights of tribes whose members own at least a 10-percent equity interest in the entity.

While the determination of whether an entity is a qualified Indian entity normally is made on a yearly basis, the Treasury Department may continue to treat entities as qualified in a year in which the 90-percent test is not satisfied solely by reason of extraordinary and nonrecurring events, such as the sale of a boat or other property.

Only fishing rights secured as of March 17, 1988, by a treaty, federal statute, or executive order are covered by this exemption. Although the fishing right must have been in existence as of March 17, 1988, it need not have been formally adjudicated or recognized as of that date.

Act Section 3042 amends the United States Code (25 U.S.C. 71) to provide that if income from fishing rights-related activity is exempt from federal tax, then such income may not be subject to tax under state or local law.

Act Section 3043 makes conforming amendments to OASOI provisions. Act Section 3044 further provides that income derived from protected Indian fishing activities is exempt from federal taxes only to the extent provided by the Act. These provisions are not intended to provide any inference as to the existence or nonexistence, or the scope, of any exemption from tax for income that is derived from fishing rights that have been previously secured by a treaty, law or executive order. To the extent that the exercise of fishing rights of any Indian tribe is entitled to a broader exemption from state taxes under any other federal or state law, this Act does not impair this additional protection afforded Indian fishing activity. For instance, income earned by Indians from activities undertaken on a reservation generally are exempt from state taxation. Thus, income earned by an Indian or Indian-owned entity from harvesting or processing fish within reservation boundaries is exempt from state taxation, regardless of whether the requirements of the Act for exemption from federal tax are satisfied.

<u>EFFECTIVE DATE OF FEDERAL PROVISIONS</u>

These provisions apply to all periods beginning before, on, or after November 10, 1988, the date of enactment of TAMRA.

<u>STATE REVENUE IMPACT</u>

Federal law prevents the taxation of such income by the states. Based on federal estimates, the revenue <u>loss</u> to California will probably not exceed the half-million dollar range annually.

TITLE IV: Extension and Modification of Expiring Tax Provisions

ACTION: EXTENDS AND MODIFIES THE EXCLUSION FROM GROSS INCOME OF EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE; AND REMOVES RESTRICTION ON EXCLUSION OF TUITION REDUCTION FOR GRADUATE TEACHERS AND RESEARCHERS.

Act Section 4001

BACKGROUND

The exclusion from an individual's gross income of the value of educational assistance provided through an employer-sponsored program is intended to help low and middle-income employees improve their education and obtain the skills needed to qualify for better jobs.

In part, Congress extended the exclusion of employer-provided educational assistance from gross income so that adequate data regarding the impact of the exclusion might be collected and evaluated. This data will be compiled from information returns filed by employers who maintain fringe benefit plans.

CURRENT CALIFORNIA LAW (Sec. 17151)

Generally, California law conforms with federal law relating to the exclusion from an individual's gross income of educational assistance provided by an employer.

Prior to January 1, 1988, an individual's gross income for California income tax purposes did not include amounts paid for the individual's educational expenses through an assistance program maintained by the employer which met certain nondiscrimination and other technical qualifications established for fringe benefit programs. This exclusion, which expired for tax years beginning after December 31, 1987, was limited to $5,250 of the educational expenses provided an individual, and did not apply to educational expenses related to sports, games or hobbies.

Individuals, who are employed by educational institutions, may exclude from their gross income for California income tax purposes the amount by which the tuition, charged for courses taken below the graduate level, is reduced for them by the educational institution. The tuition reduction offered by the educational institution must not discriminate in favor of highly compensated employees. The exclusion from gross income of the value of a reduction in tuition costs received by an individual has no established expiration date.

NEW FEDERAL LAW (Sec. 117 and 127)

This section extends, for taxable years ending in 1988 the exclusion from an individual's gross income of educational assistance received from an employer-maintained program. The exclusion had terminated on December 31, 1987.

In addition, this section restricts the gross income exclusion to that educational assistance provided by an employer for courses below the graduate level, and disallows the exclusion of employer paid expenses for courses normally taken in pursuit of an advanced (post-bachelor's) degree or an advanced course of study in medicine, law or business.

However, this section does allow graduate students, who attend a regular structured educational institution and work as teaching or research assistants, to exclude from their gross income the amount by which the institution reduces their tuition for graduate level education.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendments to IRC Sections 117 and 127 contained in this section of the act apply to tax years ending in 1988.

STATE REVENUE IMPACT

Revenue estimates for this provision have been previously estimated for AB 128 (fast-track bill) assuming enactment prior to April 15, 1989.

Based on national estimates developed by the Joint Committee on Taxation, the revenue loss under the Personal Income Tax Law is estimated to be in the $8 million range for 1988-89, of which $6 million will probably occur without regard to conformity legislation. Most industry contacts have indicated that for 1988 wage-reporting purposes no distinction is being made for possible nonconformity by California.

TITLE IV: Extension and Modification of Expiring Tax Provisions

ACTION: EXTENDS THE EXCLUSION FROM GROSS INCOME OF EMPLOYER-PROVIDED GROUP LEGAL SERVICES INSURANCE; AND RESTRICTS THE PREMIUM VALUE WHICH MAY BE EXCLUDED.

Act Section 4002

BACKGROUND

In the House Ways and Means Committee Supplement, it is reported that Congress retroactively restored certain exclusions from an individual's gross income allowed for the value of fringe benefit plans provided by an employer, so that adequate data related to the impact of the exclusion might be collected and evaluated. This data is available from information returns which are required by a federal recordkeeping and reporting statute, and are filed by employers who maintain employee fringe benefit plans. This is apparently the reason for the extension of the exclusion from gross income allowed for the cost of employer-provided group legal services insurance.

CURRENT CALIFORNIA LAW (Sec. 17131)

Prior to January 1, 1988 an individual's gross income for California income tax purposes did not include the cost of coverage in a qualified group legal services plan maintained by an employer for the benefit of employees, nor the value of legal services provided an individual employee through a qualified group plan. This exclusion expired for tax years beginning after December 31, 1987.

NEW FEDERAL LAW (Sec. 120)

This section extends, through December 31, 1988, the exclusion from an individual's gross income of the cost paid by an employer for participation in a qualified group legal services plan and the value of legal services provided to an individual through a qualified group plan maintained by an employer.

However, this section restricts the exclusion to $70 of the premium value for group insurance protection against legal expenses. This limit does not apply to the value of or reimbursement for legal services rendered to an individual.

Under this section, the $70 limit on the exclusion of a legal services plan's premium value would not affect the tax-exempt status of a group legal services trust.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This section applies to tax years beginning on or after January 1, 1988.

STATE REVENUE IMPACT

Revenue estimates for this provision have been previously estimated for AB 128 (Fast-Track Bill) assuming enactment prior to April 15, 1989.

Based on national estimates developed by the Joint Committee on Taxation the revenue loss under the Personal Income Tax Law is estimated to be in the $2.3 million range for 1989-89, of which $1.7 million will probably occur without regard to conformity legislation. Most industry contacts have indicated that for 1988 wage reporting purposes no distinction is being made for possible nonconformity by California.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: ADDS AN EXCEPTION FOR QUALIFIED BUILDINGS IN CLAIMING THE LOW-INCOME HOUSING CREDIT

Act Section 4003

BACKGROUND

No low-income rental housing credit was provided prior to the Tax Reform Act of 1986, but other tax incentives for low-income housing were available. Congress was concerned that the tax preferences for low-income rental housing available under prior law were not effective in providing affordable housing for low-income individuals. Congress believed a more efficient mechanism for encouraging the production of low-income rental housing could be provided through the low-income rental housing tax credit.

The low-income housing credit may be claimed by owners of qualified low-income housing projects that are constructed, rehabilitated or acquired after December 31, 1986. Such projects are any projects for residential rental property that meet the requirements for low-income tenant occupancy, gross rent restrictions, state credit authority and IRS certification.

The credit may be claimed over a ten-year period that begins with the tax year in which the property is placed in service, or at the taxpayer's election, the next tax year. A building must be a qualified low-income building as of the close of the first year of such period. To qualify for the credit, a building must be placed in service during the year for which the state allocated the credits.

Generally, any building eligible for the credit must receive an allocation of credit authority from the State or local credit agency in whose jurisdiction the qualifying low-income housing project is located. The aggregate amount of such credits allocated within the State is limited by the State annual low-income credit authority limitation. No carryover authority for unused credit authority is permitted.

In all cases, credit allocations are counted against a State's credit authority limitation for the calendar year in which the credits are allocated. Congress intended that credits may be allocated only during the calendar year in which the building or rehabilitated property is placed in service, except in the case of (1) credits claimed on additions to qualified basis and (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service.

For buildings placed in service after 1987, an additional exception is enacted to allow state low-income housing credit dollar amounts allocated in calendar years after 1987 to be carried over if the building meets certain criteria.

CURRENT CALIFORNIA LAW (Sec. 17058 and 23610.5)

California allows a credit against net tax for taxpayers who provide low-income housing. The California credit is based on the federal low-income housing credit contained in federal law, but with major modifications.

Unlike federal law, the California credit is claimed over a four-year period, rather than over a ten-year period. In addition, to qualify for the California credit, a California low-income housing project must meet the requirements for the federal low-income housing credit and must either have been allocated a federal credit by the Mortgage Bond and Tax Credit Allocation Committee or else have been at least 70%-financed by tax-exempt bonds subject to the volume cap contained in federal law.

NEW FEDERAL LAW (Sec. 42(h)(1))

The new provision adds an exception for qualified buildings to qualify for the carryover of the low-income housing credit. This provision provides that a building, other than an existing building, can retain its credit as long as the building is 10 percent complete in the year the credit is taken and placed into service by the end of the second succeeding year. To compute the 10 percent completion test, the taxpayer's basis in the project (of which the building is a part) at the end of the first year must exceed 10 percent of the taxpayer's reasonably expected basis at the end of the following year.

In addition, this provision repeals the carryover allowed from 1989 to 1990 where 10 percent of the cost had been incurred by January 1, 1989.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to amounts allocated in calendar years after 1987.

STATE REVENUE IMPACT

California currently has an annual $35 million maximum authority to issue housing credits. The federal change would not affect this annual ceiling on potential revenue losses.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: DELETES THE RESTRICTION ON CORPORATE OWNERSHIP AND REVERSES THE ELECTION TO RECAPTURE THE LOW INCOME RENTAL HOUSING CREDIT

Act Section 4004

BACKGROUND

No low-income rental housing credit was provided prior to the Tax Reform Act of 1986, but other tax incentives for low-income housing were available. Congress was concerned that the tax preferences for low-income rental housing available under prior law were not effective in providing affordable housing for low-income individuals. Congress believed a more efficient mechanism for encouraging the production of low-income rental housing could be provided through the low-income rental housing tax credit.

The low-income housing credit may be claimed by owners of qualified low-income housing projects that are constructed, rehabilitated or acquired after December 31, 1986. Such projects are any projects for residential rental property that meets the requirements for low-income tenant occupancy, gross rent restrictions, state credit authority and IRS certification.

The credit is subject to the rules of the general business credit and the carryforward and carryback rules. The credit may be claimed over a ten-year period that begins with the tax year in which the property is placed in service, or at the taxpayer's election, the next tax year. However, the building must be a qualified low-income building as of the close of the first year of such period.

If the property on which a low-income housing credit is claimed ceases to qualify as low-income rental housing or is disposed of before the end of a 15-year compliance period, a portion of the credit must be recaptured. In the case of a disposition, recapture generally is determined at the level of each owner. However, in the case of a partnership having more that 35 partners and none of whom is a corporation, the partnership may elect to compute recapture at the partnership level rather than at the partner level. This election is applicable when there are 35 or more individuals or estates that own more than 50 percent of the partnership's capital and profit interests.

CURRENT CALIFORNIA LAW (Sec. 17058 and 23610.5)

California is generally in conformity with federal law. However, California does not require the recapture of low-income housing credit. Instead, the California credit requires that the property on which the credit is claimed must qualify as a low-income rental housing for a compliance period of 30 years rather than 15 years under federal law.

NEW FEDERAL LAW (Sec. 42(h)(1)

TAMRA modifies the election under prior law and requires all large partnerships (whether or not containing corporate partners) to compute recapture at the partnership level and then flow through to each partner their portion of the recapture based on ownership percentage, unless the partnership elects to have recapture applied at the partner level. This election must be made within six months after November 10, 1988.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applied to buildings placed in service after December 31, 1986 and amounts allocated in calendar years after 1987.

STATE REVENUE IMPACT

Not applicable.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: EXTENDS AUTHORITY FOR ONE YEAR

Act Section 4005

BACKGROUND

The federal government provisions which grant states authority to issue mortgage credit certificates (MCC) and qualified mortgage bonds (QMB) were due to expire on December 31, 1988. These programs were enacted to provide government help to first time home buyers.

CURRENT CALIFORNIA LAW

California participates in the federal program through the Mortgage Bond and Tax Credit Allocation Committee. The state, however, did not grant credits on state income tax forms for MCCs issued. Any interest earned on a QMB issued by California is exempt from state income tax as an obligation issued by the state.

NEW FEDERAL LAW (Sec. 25,26,143,148, 6045 and 6654)

Authority of states to issue MCCs and QMBs is extended for one year. In addition numerous rules are imposed for that one year period. See detailed explanation at CCH paragraph 3820.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions apply generally to bonds issued, and nonissued bond amounts elected, after December 31, 1988.

STATE REVENUE IMPACT

The revenue impact from previous issues of QMBs at the state level is not readily available.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: EXTENDS THE EXPIRATION DATE OF THREE BUSINESS ENERGY CREDITS FOR

1. SOLAR ENERGY PROPERTY;
2. GEOTHERMAL PROPERTY;
3. OCEAN THERMAL PROPERTY;
FROM DECEMBER 31, 1988 TO DECEMBER 31, 1989.

Act Section 4006

BACKGROUND

The business energy investment tax credits were enacted to provide an incentive for the purchase of specific property or equipment.

Even though the Tax Reform Act of 1986 repealed the regular investment credit, it still allowed businesses to take an investment credit for certain energy expenditures through December 31, 1988. These expenditures must be in connection with solar energy property, geothermal property, and ocean thermal property. Under prior provisions, all of these credits were to have expired at the end of 1985.

CURRENT CALIFORNIA LAW

California has never conformed to the federal investment tax credit. Current California law contains a credit for certain specified commercial solar energy systems, however, the provisions are substantially different than the federal law.

NEW FEDERAL LAW (Sec. 46(b)(2)(A))

The Act amends federal law to extend the expiration date of the three remaining business energy credits relating to:

1. solar energy property;
2. geothermal property; and
3. ocean thermal property.

These credits are extended through December 31, 1989 at their 1988 tax credit rates.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The extension is effective for property placed in service on or after January 1, 1989.

STATE REVENUE IMPACT

California has differed from federal law over the years with regard to the provision of energy-related tax credits. California's solar energy credit related to commercial property expired January 1, 1989 and it was the only credit available to taxpayers for the 1987 and 1988 income/taxable years (except for unused carryover credits from prior years for other energy-related credits). A one-year extension of the state commercial solar credit would result in an estimated $4 million revenue loss.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: EXTENDS THE EXPIRATION DATE OF THE CREDIT FOR RESEARCH EXPENDITURES FOR ONE YEAR

Act Section 4007 and 4008(b)

BACKGROUND

The aim of the research and development credit, available since the Economic Recovery Tax Act of 1981, was to promote R&D investment by providing an incentive, by way of tax reduction, for qualified incremental expenditures for research activities. The R&D credit survived the 1986 tax reform, although it was further limited.

Under the Tax Reform Act of 1986, Congress granted a three-year extension to the research tax credit, which was scheduled to expire at the end of 1985. The credit was extended for eligible expenses paid or incurred through December 31, 1988. The law reduced the credit from 25 percent to 20 percent and kept the base-period rule only for qualified research expenses, which were defined more narrowly than under prior law. The base period is the three-tax-period ending with the tax year immediately preceding the first tax year of the taxpayer beginning after December 31, 1983. For tax years beginning after 1986, the new law also introduced a special set of operating rules for "basic research expenses," a new category that replaced prior law's contract research expenses.

The amount of any deduction allowable to a taxpayer for research expenses for basic research payments was not reduced by the amount of any credit also allowed to the taxpayer for the same research expenses or basic research payments.

These incentives were not necessarily sufficient to maintain the United States' competitive edge; therefore, the legislation provided for a study of the current structure of the research credit and for timely reporting of needed improvements.

CURRENT CALIFORNIA LAW (Sec. 17052.12 and 23609)

California Personal Income Tax Law and Bank and Corporation Tax Law in 1987 were generally conformed to federal law, which allows a credit for increased research expenditures for amounts paid or incurred in a trade or business. Unlike Federal law, the credit applies to the years 1988 through 1992 (i.e. expenses must be paid or incurred on or after January 1, 1988, and before January 1, 1993).

California's credit has the following differences:

1. The California percentage is 8 percent of the excess of qualified research expenses for the tax year over the base period research expenses and 12 percent of the basic research payments.

2. The research must be conducted in California.

3. If the credit exceeds the taxpayer's net tax liability for the taxable year, that portion of the credit which exceeds the net tax liability may be carried over to the net tax in succeeding taxable years.

4. The credit applies only for expenses incurred before January 1, 1993.

NEW FEDERAL LAW (Sec. 41(h) and (i))

The federal law is amended to extend the expiration date for research expenses to apply to those paid or incurred before January 1, 1990. In addition an election is provided for a taxpayer to capitalize the expenses rather than claim the credit.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The extension is effective for expenses paid or incurred during 1989. The addition of the election to capitalize expenses applies to taxable years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

The one-year extension is not applicable. California has enacted its own credit with certain differences from the federal provision and a later sunset date. The revenue effect from an election to capitalize expenses is unknown.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: DENIAL OF DEDUCTION FOR AMOUNTS ALLOWED AS A RESEARCH CREDIT

Act Section 4008(a)

BACKGROUND

As a general rule, business expenditures to develop or create an asset that has a useful life extending beyond the taxable year, such as expenditures to develop a new product or improve a production process, must be capitalized. However, federal law permits a taxpayer to deduct currently (or amortize over certain periods) the amount of research or experimental expenditures incurred in connection with the taxpayer's trade or business.

In addition, both state and federal law provide a tax credit for the amount of qualified research expenditures paid or incurred by the taxpayer during a taxable year that exceeds the average of the taxpayer's qualified research expenditures in the base period (generally, the three preceding taxable years). The credit also applies to certain payments to universities for basic research.

Under current state and federal law, the amount of the taxpayer's deduction for research expenditures is not reduced by the amount of any credit also allowed to the taxpayer for the same research expenditures.

CURRENT CALIFORNIA LAW (Sec. 17052.12 and 23609)

California allows a tax credit for qualified research expenditures. The state credit is 8 percent for in-house research and 12 percent for university research while the federal credit is 20 percent for both types of research. The state credit applies to expenditures made before 1993.

NEW FEDERAL LAW (Sec. 280C)

The act amends federal law to provide that no deduction is allowed for that portion of the qualified research expenses or basic research expenses otherwise allowable as a deduction for the year which equals 50 percent of the amount of the credit. A new rule is added under which the taxpayer may elect to capitalize rather than expense the qualified research expenses. By electing this rule, the taxpayer avoids the reduction of the deduction where the limitation by the alternative minimum tax prevents the full use of the credit. The following example illustrates this new provision.

EXAMPLE:

John made credit-eligible research expenses of $900,000 during the year; the base period amount is $500,000. John is allowed a tax credit equal to 20 percent of the $400,000 increase in research expenses, or $80,000. Under the new provision, John's deduction is reduced by 50 percent of the $80,000 credit or $40,000, leaving a deduction of $860,000.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for tax years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

State revenue gains under conformity are estimated to be in the $1.5 million range for 1989-90 and less than $0.5 million for 1990-91.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: MODIFIES THE GENERAL BUSINESS CREDITS WHICH QUALIFY FOR A DEDUCTION FOR THE PORTION OF THE UNUSED CREDIT

Act Section 4008(b)

BACKGROUND

The federal law identifies qualified business credits a taxpayer may claim in any one year. These credits are combined to determine the limitation in the allowable amount of credit based on the taxpayer's tax liability for the year. Amounts that are not currently creditable may be carried forward, subject to the carryback and carryforward provisions of unused credits. If at the end of the carry forward period (15 years) the credits still have not been claimed, the taxpayer is entitled to a compensating deduction in the first tax year after the credits expire.

This provision of the law was enacted in order to allow taxpayers the benefit of receiving some tax relief from the portion of their unused credits.

CURRENT CALIFORNIA LAW

Since California does not allow a general business credit there is no provision which allows a deduction for unused business credits.

NEW FEDERAL LAW (Sec. 196)

The extension of the expiration date for the research expenditure credit has a flow-through effect on Internal Revenue Code Section 196(c) and (d). These subsections were modified to include the research credit for purposes of the definition for unused business credits. As is the case for the investment credit, the deduction is limited to 50 percent of the unused credit.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modification is effective for tax years beginning after December 31, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE IV: Extensions and Modifications of Expiring Tax provisions

ACTION: MODIFIES THE EFFECTIVE DATE OF QUALIFIED RESEARCH EXPENSES FOR PURPOSES OF DEFINING QUALIFIED CLINICAL TESTING EXPENSES.

Act Section 4008(c)(1)

BACKGROUND

Federal law allows a credit, separate from the general business credit, equal to 50 percent of the qualified costs for clinical testing of "orphan drugs", for tax years beginning after 1982. Internal Revenue Code Section 28(b) provides a definition of qualified clinical testing expenses by referencing Internal Revenue Code Section 41(b) which sets forth the meaning of qualified research expenses.

Under the *Tax Reform Act* of 1986, Congress extended the credit for the clinical testing of "orphan drugs", which was scheduled to expire at the end of 1985. The credit was extended through December 31, 1990. These "orphan drugs" are drugs that are either:

1. for diseases or conditions affecting less than 200,000 people in the United States, or

2. cannot reasonably be expected to make a profit from United State sales when all development and marketing costs are determined.

Even though the same expenses cannot be used to claim the research credit and "orphan drug" credit, these expenses must be used in computing the research credit base period expenses.

Congress enacted this provision to provide American medical research companies with the incentive to develop research in areas where the possibility of profit for the company does not always exist. This credit allows such companies some tax advantage for offsetting their tax liability.

CURRENT CALIFORNIA LAW (Sec. 17057 and 23609.5)

California Personal Income Tax Law and Bank and Corporation Tax Law are generally in conformity with federal law, which allows a credit against net tax for qualified clinical testing expenses in connection with the development of drugs for rare diseases. For California purposes, the credit applies to the years 1987 through 1992.

California allows the credit in accordance with the federal law except as follows:

1. The California percentage is 15 percent of the qualified clinical testing expenses for the taxable year.

2. The testing must be conducted in California.

3. If the credit exceeds the taxpayer's net tax liability for the taxable year, that portion of the credit which exceeds the net tax liability may be carried over to succeeding taxable years.

NEW FEDERAL LAW (Sec. 28)

The extension of the expiration date for the research expenditure credit has a flow-through effect on Internal Revenue Code Section 28(b). This subsection refers to Section 41 for purposes of defining qualified clinical testing expenses. Since the expiration date for the research credit has been extended for one year, including the definition of qualified clinical testing expenses, the subsection referring to the definition is also extended one year.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The extension is effective for tax years beginning after December 31, 1988.

STATE REVENUE IMPACT

California's orphan drug credit applies through 1992. Annual revenue losses are estimated to be in the $1 million range.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: LIMITS THE TIME IN WHICH THE INTERNAL REVENUE SERVICE CAN ASSESS A DEFICIENCY FOR THE CREDIT ELECTION.

Act Section 4008(c)(2)

BACKGROUND

Internal Revenue Code Section 6501 provides the statute of limitations for assessments and collections made by the Internal Revenue Service. Specifically, for deficiencies attributable to election of certain credits applies to the alcohol fuel credit and the targeted job credit, which the taxpayer may elect not to claim. Alternatively, the taxpayer may elect to capitalize the costs rather than expense the costs. This section applies a limitation of time for assessing a deficiency due to this election (or revocation).

The statute of limitations for assessing a deficiency on this election is limited to one year after the date in which the Internal Revenue Service has been notified of the election (or revocation).

CURRENT CALIFORNIA LAW (Sec. 18586)

California law differs from federal law in that the statute of limitations on assessments is the later of four years from the due date of the return or the date on which the return was filed.

NEW FEDERAL LAW (Sec. 6501(n))

The effect on this section of the federal law is the result of a flow-through from the modification of the credit for increasing research expenditures (IRC 41). A taxpayer may elect to capitalize his/her research costs rather than expense the costs. Therefore, this section is modified to apply a one year limitation on deficiencies attributable to this election (or revocation). Specifically, this section allows the Internal Revenue Service up to one year to determine if a correct election (or revocation) was made to have the research credit not apply.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The extension is effective for tax years beginning after December 31, 1988.

STATE REVENUE IMPACT

Not applicable. The operation of California's statute of limitations does not depend on notification of a specific election.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: PROVIDES GUIDANCE RELATING TO THE ALLOCATION AND APPORTIONMENT OF RESEARCH AND EXPERIMENTAL EXPENDITURES FOR ACTIVITIES CONDUCTED INSIDE AND/OR OUTSIDE THE UNITED STATES

Act Section 4009

BACKGROUND

Prior to the Tax Reform Act of 1986, a suspended Treasury Regulation required taxpayer with foreign source income from products in which the taxpayer incurs United State research expenses, to allocate a portion of their U.S. research expenses against foreign source income. In 1981, Congress suspended this rule for two years to allow U.S. research expenses to generally offset U.S. source income. In 1984, Congress extended this suspension for two additional years.

The Tax Reform Act of 1986 modified the rules for allocating research and experimental expenses against U.S. and foreign-source income for one-year. The modification was extended to allow Congress sufficient time to analyze the need for a permanent tax incentive program. The law provided that 50 percent of a taxpayer's U.S. incurred research and experimental expenses be apportioned to U.S. income and the remainder apportioned on the basis of gross sales to gross income. The law was effective for tax year beginning after August 1, 1985 and on or before August 1, 1987.

However, if the research expenses are incurred to meet legal requirements as to improvements or marketing of specific products or processes and the results are not likely to generate much gross income outside a single source, they will be allocated entirely to that source.

Congress in TAMRA enacted a new provision to continue offering permanent tax incentives for U.S. research expenditures.

CURRENT CALIFORNIA LAW

California does not have a provision relating to the allocation of research and experimental expenditures but instead uses the unitary method to determine the income attributable to California.

NEW FEDERAL LAW (Sec. 861(b), 862(b) and 863(b))

The new provision provides guidance on how research and experimentation expenses are to be allocated between foreign and U.S. source income. These allocation rules apply to IRC Sections 861(b), sources within the U.S.; 862(b), sources outside the U.S.; and 863(b), sources partially within and partially outside the U.S.

First, the provision allocates any qualified research and experimental expenses incurred to met legal requirements imposed by political entities in regards to the improvement or marketing of specific products that cannot be reasonably expected to generate gross income outside the geographic area of the political entity to be allocated to that geographic area.

After taking out those expenses, 64 percent of the remaining research and experimentation expenses are to be allocated to the place where the activities are performed. Therefore, 64 percent of the remaining qualified research and experimental expenses conducted in the U.S. are allocated to income from U.S. sources and 64 percent of expenses for research and experimental expenses conducted outside the U.S. are allocated to foreign sources. After subtracting this amount, the remaining portion of the expenses will be apportioned on the basis of either gross sales or gross income. However, if the taxpayer elects to use gross income, the amount apportioned to foreign sources must be at least 30 percent of the amount that would be apportioned to foreign sources on the basis of gross sales.

In addition, the provision clarifies the rules for research conducted in space, on or beneath the ocean, or on Antarctica. Research expenses incurred by U.S. persons for activities conducted in such areas will be allocated and apportioned in the same manner as activities conducted in the U.S. However, expenses incurred by a non-U.S. person will be allocated and apportioned in the same manner as activities conducted outside the U.S.

For affiliated groups of companies, the expenses will be allocated as if all members of the group, plus any possessions corporations, were a single corporation. There are special allocation rules for U.S. possessions corporations. The allocation provision applies to the portion that bears the same ratio to total qualified research and experimental expenses as:

1. the lessor of four months or the number of months in the tax year, bears to

2. the number of months in the tax year.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to foreign research and experimental expenses incurred for the first four months of the first taxable year beginning after August 1, 1987, with such expenditures treated as if incurred ratably throughout the taxable year.

For U.S. possession corporations, the provisions apply to the taxpayer's first taxable year beginning after August 1, 1987. However, the rules apply only to a portion of the taxpayer's qualified research and experimental expenditures for that tax year.

STATE REVENUE IMPACT

Not applicable.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: EXTENDS TARGETED JOB CREDIT FOR ONE YEAR AND MODIFIES THE CREDIT FOR DISADVANTAGED SUMMER YOUTH EMPLOYEES.

Act Section 4010

BACKGROUND

The targeted job credit came into existence in 1979 as an incentive to employers to hire persons from specified groups which have a high rate of unemployment or special employment needs.

The California targeted job credit provisions have been amended several times. These amendments include technical corrections, additions of targeted groups, extension of expiration dates, changes in the age requirements, and changes in the percentage of credit allowed. Thus, the state credit is substantially different that the federal credit.

CURRENT CALIFORNIA LAW (Sec. 17053.7 and 24330)

The California Personal Income Tax Law and Bank & Corporation Tax Law allow a limited credit for wages paid to certain qualified employees. At present, the California credit is 10 percent of the first $3,000 of wages paid during the taxable year and continues for a 24-month period beginning with the first day of employment. The credit is limited to an aggregate of $600 per qualified employee. A qualified employee is defined as:

1. an individual unrelated to the taxpayer and

2. certified by the California Employment Development Department under Unemployment Insurance Code Section 328 or by the State Department of Social Services.

The California credit, unlike the federal credit, allows the job credit for wages paid to temporary laborers hired during a labor dispute. The California credit does not provide a greater benefit to employers hiring summer youth (85% vs 40% for federal).

In addition, if the wages upon which the credit is allowed qualify as a deductible expense, California law allows a business expense deduction in addition to the credit. Federal law prohibits a deduction where a credit is allowed.

The current California credit does not apply to individuals hired after December 31, 1989.

NEW FEDERAL LAW (Sec. 51(c) and (d))

Under the new provision, federal law is amended to extend the credit to amounts paid or incurred to a targeted-group individual who begins work for the employer after December 31, 1988 and before January 1, 1990.

The Act also limits the credit in two respects for disadvantaged summer youths. First, the category of economically disadvantaged youths is restricted to those aged 18 through 22. Second, the Act reduces the credit amount from 85 percent to 40 percent.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies with respect to targeted-group individuals who begin work for the employer after December 31, 1988 and before January 1, 1990. The credit does not apply with respect to individuals who begin work for the employer after December 31, 1989.

The authorization for appropriations is effective for the period October 1, 1988 through September 30, 1989 (fiscal year 1989).

STATE REVENUE IMPACT

Not applicable. The California credit already applies to individuals hired before January 1, 1990.

TITLE IV Extensions and Modifications of Expiring Tax Provisions

ACTION: CODIFIES AN EXCEPTION THAT EXPENSES OF PUBLICLY OFFERED MUTUAL FUNDS ARE NOT TREATED AS MISCELLANEOUS ITEMIZED DEDUCTIONS SUBJECT TO TWO-PERCENT FLOOR

Act Section 4011

BACKGROUND

For tax years beginning after 1986, certain miscellaneous itemized deduction are deductible only by an individual to the extent that the cumulative total of these expenses exceeds two percent of the taxpayer's adjusted gross income. Under the Tax Reform Act of 1986, the Treasury was directed to issue regulations that would prevent an individual's use of pass-through entities to deduct expenses that would not otherwise be deductible if the individual incurred the expenses directly.

The pass-through restrictions would apply to indirect expenses from regulated investment companies (mutual funds). Each shareholder would report his share of gross income from the fund, but his share of the fund's expenses would be subject to the two-percent floor. The 1987 Omnibus Reconciliation Act delayed treatment of the expenses from publicly offered mutual funds as miscellaneous itemized deductions until tax years beginning after 1987.

Congress in TAMRA enacted a new provision to extend the exemption for publicly traded mutual funds as provided in the Omnibus Reconciliation Act of 1987. For tax years beginning after 1989, the exemption will not apply. But, as the Act is now written, neither will the pass-through regulations. This was a drafting error since the new provision gives the Treasury Department the authority to issue pass-through regulations. Unless the provision is corrected, publicly offered mutual funds and any other pass-through entity will not be subject to legislative regulations.

CURRENT CALIFORNIA LAW (Sec. 17076)

Although California has incorporated Internal Revenue Code Section 67 for taxable years beginning on or after January 1, 1987, it also incorporated Section 10104 of the Revenue Act of 1987. This section delays the application of the two-percent floor to publicly offered regulated investment companies until taxable years that begin on or after January 1, 1988. Since a new provision has not been enacted or incorporated for California purposes, indirect mutual fund shareholder expenses for tax years beginning after 1987 are deductible only as miscellaneous itemized deductions and are subject to the two-percent floor.

NEW FEDERAL LAW (Sec. 67(c))

The new provision amends the section relating to miscellaneous deductions from pass-through entities by adding publicly offered regulated investment companies (mutual funds) to the section. Under the provision, the expenses of publicly offered mutual funds will not be treated as miscellaneous itemized deductions subject to the two-percent floor for tax years beginning in 1988 and 1989.

The new law defines mutual funds as having its shares:

1. publicly offered under Section 4 of the Securities Act of 1933,

2. regularly traded on an established securities market, or

3. held by or for no fewer than 500 shareholders at all times during the taxable year.

In addition, the provision authorizes the Treasury Department to issue regulations reducing the 500 shareholder requirement where the mutual fund experiences a loss of shareholders through the net redemption of their shares.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for taxable years beginning after December 31, 1987.

STATE REVENUE IMPACT

Based on national estimates by the Joint Committee on Taxation, comparable revenue losses under the Personal Income Tax Law are estimated to be in the $12 million range for 1988-89 and the $10 million range for 1989-90. These losses are primarily baseline revenue effects which for California purposes will automatically occur due to the nonreporting of expense information to shareholders.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: EXTENDS THE TAX-FREE REORGANIZATION RULES FOR INSOLVENT FINANCIAL INSTITUTIONS TO APPLY TO OWNERSHIP CHANGES OCCURRING AFTER DECEMBER 31, 1988 AND BEFORE JANUARY 1, 1990

Act Section 4012(a)

BACKGROUND

The law contains statutory language enacted to facilitate the recovery of financially troubled savings and loans in order to protect the interests of depositors and employees. As these types of institutions continue to experience financial problems, the law is being perfected to address more specific tax problems and to widen the scope of application to other financial institutions beyond savings and loans.

More specifically, provisions relating to "G" reorganizations (commonly named from the federal code section citation (IRC Sec. 368(a)(1)(G)) relating to the reorganization of insolvent savings institutions which were due to expire December 31, 1988 were extended one year.

CURRENT CALIFORNIA LAW (Sec. 24562)

California law is in conformity with prior federal law with regard to the reorganization of insolvent financial institutions, however the state provision does not apply to acquisitions after December 31, 1988.

NEW FEDERAL LAW (Sec. 382(1)(5)(F))

Under prior federal law, the special provisions for insolvent savings institutions were due to expire December 31, 1988. This act extends the federal provisions for one year.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The rules are effective for ownership changes occurring after December 31, 1988 and before January 1, 1990.

STATE REVENUE IMPACT

State revenue losses from an extension of FSLIC provisions would be significant. National estimates by the Treasury and the Joint Committee on Taxation are characterized as tentative and subject to revision at any time. The development of state estimates will depend on the availability of relevant state-specific information from federal sources.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: EXTENDS THE SPECIAL RULES FOR FINANCIALLY TROUBLED FINANCIAL INSTITUTIONS TO BANKS AND DOMESTIC BUILDING AND LOAN ASSOCIATIONS

Act Section 4012(b)

BACKGROUND

The law contains statutory language enacted to facilitate the recovery of financially troubled savings and loans in order to protect the interests of depositors and employees. As these types of institutions continue to experience financial problems, the law is being perfected to address more specific tax problems and to widen the scope of application to other financial institutions beyond savings and loans.

More specifically, assistance payments received from the Federal Deposit Insurance Corporation (FDIC) are not includable in the income of banks and building and loan associations to which the payment are made, and no reduction in basis is required as a result of such payments. Other provisions relating to the treatment of net operating losses, loan portfolio built-in losses and interest expenses as a result of these payments, and repayments are extended to such institutions, as well as making the tax-free reorganization rules apply regardless of whether continuity of interest of the transferor exists.

CURRENT CALIFORNIA LAW (Sec. 24322 and 24562(d))

California law is in conformity with prior federal law with regard to the treatment of assistance payments from the Federal Savings and Loan Insurance Corporation (FSLIC) prior to the enactment of the TAMRA provisions. However, the state provision does not apply to amounts received after December 31, 1988 in income years ending after that date.

NEW FEDERAL LAW (Sec. 368(a), 382(1), 597)

Under prior federal law, the provisions relating to financially troubled financial institutions applied to savings and loans only.

Under TAMRA, assistance payments received from the Federal Deposit Insurance Corporation (FDIC) are not includable in the income of banks and building and loan associations to which the payments are made, and no reduction in basis is required as a result of such payments.

Also, provisions relating to the treatment of net operating losses, loan portfolio built-in losses and interest expenses as a result of these payments, and repayments of the assistance are extended to such institutions.

In addition, tax-free reorganization status is extended to these institutions, regardless of whether continuity of interest of the transferor exists.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new rules for banks are effective for payments made after December 31, 1988 through December 31, 1989.

STATE REVENUE IMPACT

National estimates indicate that revenue losses attributed to the extension of tax-free reorganization provisions to banks would not be significant as long as the generally healthy condition of the industry continues. This generalization also applies to California banks. According to the California Banker's Association, FDIC has not provided financial assistance to a California bank for the 1983-87 period. Bank failures have been primarily small banks for which FDIC has either found an institution to assume the liabilities or paid off depositors.

TITLE IV: Extensions and Modifications of Expiring Tax Provisions

ACTION: ESTABLISHES SPECIAL RULES FOR FINANCIALLY TROUBLED FINANCIAL INSTITUTIONS GOVERNING THE CARRYFORWARD OF NET OPERATING LOSSES, BUILT-IN LOSSES AND THE TREATMENT OF REPAYMENTS.

Act Section 4012(c)

BACKGROUND

The law contains statutory language enacted to facilitate the recovery of financially troubled savings and loans in order to protect the interests of depositors and employees. As these types of institutions continue to experience financial problems, the law is being perfected to address more specific tax problems and to widen the scope of application to other financial institutions beyond savings and loans.

More specifically, when assistance payments received from the Federal Savings and Loan Insurance Corporation (FSLIC) or the Federal Deposit Insurance Corporation (FDIC) (which are not includable in income), then net operating losses, loan portfolio built-in losses and interest expenses are reduced by 50% of the payments. Built-in portfolio losses to be reduced include built-in losses on property, losses on marketable securities, and built-in loan portfolio losses. If any assistance payment is repaid, the taxpayer may adjust prior year deductions that were reduced as a result of the 50% rule.

CURRENT CALIFORNIA LAW (Sec. 24322)

California law is in conformity with prior federal law with regard to the treatment of assistance payments from FSLIC prior to the enactment of the TAMRA provisions, however, the state provisions do not apply to amounts received after December 31, 1988 in income years ending after that date.

NEW FEDERAL LAW (Sec. 597(c))

Under prior federal law, the special provisions for financially troubled savings and loans were due to expire December 31, 1988. This act extends the federal provisions for one year.

Under the new provisions, assistance payments to financially troubled financial institutions made from the FDIC or FSLIC reduce net operating losses, loan portfolio built-in losses and interest expenses by 50% of the payments.

Also, the new law specifies that in determining the built-in portfolio losses to be reduced by the percentage of assistance payments, such losses include built-in losses on property, losses on marketable securities, and built-in loan portfolio losses.

In addition, TAMRA addresses the repayment of any assistance payment, stating that the taxpayer may deduct an amount equal to any deductions they may have made in prior tax years as a result of the 50% reduction rule for assistance payments received.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The rules are effective for payments made after December 31, 1988 through December 31, 1989.

STATE REVENUE IMPACT

Pending. State revenue estimates depend on the availability of relevant state-specific information from federal sources.

TITLE V: Revenue Increase Provisions

SUBTITLE A: Corporate Estimated Tax Provisions

ACTION: REQUIRES ANY CORPORATION USING THE ANNUALIZATION EXCEPTION TO MAKE UP 100 PERCENT OF THE SHORTFALL TO AVOID AN ESTIMATED TAX PENALTY

Act Section 5001

BACKGROUND

A corporation must make estimated tax payments. For tax years beginning after December 31, 1987, every corporation is required to make four installment payments of estimated tax. Each installment is equal to 25 percent of the corporation's required annual payment. The required annual payment is lesser of 90 percent of the tax shown on the return for the current year or 100 percent of the tax for the preceding year, for other than large corporations.

The most widely applicable exception to penalties for underpayment of estimated taxes is the annualized income exception. Under current law, the required payment amount is computed by multiplying each installment by a percentage (22.5 percent for installment 1, 45 percent for installment 2, 67.5 percent for installment 3, and 90 percent for installment 4) by the full tax payable on annualized income, subtracting any prior tax payments. For both large and small corporations the amount of any required payment does not have to exceed an amount that would be due if the total payments up to the installment due equal 90 percent of the tax due if the income was annualized. Any reduction in an installment payment from using annualized income must be made up in the subsequent payment if the corporation does not use the annualized method to compute that payment. If the subsequent installment makes up at least 90 percent of the prior installment's shortfall, no penalty is imposed.

Congress was concerned that two corporations, one with fluctuating income (especially one with low income for the first part of the year) and one with steady income flow throughout the year are subject to different estimated tax liabilities. Therefore, Congress enacted a provision which eliminates the ability of corporations with fluctuating income to reduce the total amount of estimated tax payments owed for any year.

CURRENT CALIFORNIA LAW (Sec. 25954)

All corporations subject to franchise or income tax are required to pay estimated tax during the income year. A corporation that does not pay its estimated tax when due may be charged an underpayment penalty for the period of underpayment. California law is substantially different than federal law.

The California penalty has provisions for use of the annualization method of estimating income. First, there is no penalty if the installment is at least 90 of the tax due, annualized from the first of the year to the end of the month preceding each installment month. The second exception is for corporations earning seasonal income. This exception is generally the same as that contained in federal law.

Corporations with seasonal income which, in the preceding three taxable years, have had taxable income for any period of six successive months that averaged 70 percent or more of the total income for the taxable year qualify for this exception. They may annualize their income by assuming that the income is earned, in the current year, in the same pattern as in the preceding taxable years. Estimated income taxes would be required to be paid in the same seasonal pattern in which earned.

NEW FEDERAL LAW (Sec. 6655(e)(1))

Under the new provision, any corporation using the annualization exception must make up 100 percent of the shortfall in the subsequent installment to avoid an estimated tax penalty.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for estimated tax payments required to be made after December 31, 1988.

STATE REVENUE IMPACT

Not applicable under California's estimated tax structure.

TITLE V: Revenue Increase Provisions

SUBTITLE B: Insurance Provisions

ACTION: LIMITS THE AMOUNT OF MORTALITY AND EXPENSE CHARGES THAT CAN BE TAKEN INTO ACCOUNT IN DETERMINING WHETHER A CONTRACT MEETS THE DEFINITION OF LIFE INSURANCE

Act Section 5011

BACKGROUND

In the Deficit Reduction Act of 1984, Congress attempted to reduce the tax advantage of single premium life and other investment-oriented insurance contracts. That Act attempted to limit the tax-deferred growth of these types of contracts by requiring them to meet strict guidelines in order to qualify as a life insurance contract. Under those rules, a contract qualifies if it is a life insurance contract under applicable state or foreign law and it meets either of these tests:

1. Cash-value accumulation test;

2. Guideline premium/cash-value corridor test.

The greater the mortality and expense charges, the greater the allowable cash surrender value under the cash-value accumulation test or the amount of the premium that can be paid for the contract under the guideline premium test. As a result, insurance companies have been able to maximize tax-deferred buildup within the guideline prescribed by stating higher mortality and expense charges than the company actually charges.

Congress enacted a new provision to limit the amount of mortality and expense charges that can be taken in determining whether a contract meets the definition of a life insurance contact.

CURRENT CALIFORNIA LAW (Sec. 17020.6 and 23045)

California law is in conformity with federal law.

NEW FEDERAL LAW (Sec. 7702(c))

This Act modifies the federal law with regard to mortality and expense charges. Under the new provision, the mortality charges are limited to reasonable charges as determined in regulations. And, except as provided in those regulations, the charges may not exceed the amounts specified in standard tables at the time the contract is issued. The Secretary of the Treasury is directed to issue regulations by January 1, 1990 to set forth the standards for determining the reasonableness of mortality charges. Pending the issuance of regulations, mortality charges are to be deemed reasonable if they do not differ materially from the charges actually expected to be imposed by the company, taking into account any relevant characteristics of the insured of which the company is aware.

Also, expense charges must be reasonable and must be charges that are reasonably expected to actually be paid. This provision provides that companies with no experience in determining reasonable charges may, to the extent allowed under regulations, use the industry-wide experience to make such determination. Furthermore, no charge will be taken into account, if a charge is not specified in a contract.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to contracts entered into on or after October 21, 1988.

STATE REVENUE IMPACT

The Joint Committee on Taxation has included this rather minor provision with Act Section 5012 (new limits on modified endowment contracts). Refer to the latter provisions for combined state revenue impact.

TITLE V: Revenue Increase Provisions

SUBTITLE B: Insurance Provisions

ACTION: ENACTS NEW LIMITS ON MODIFIED ENDOWMENT CONTACTS

Act Section 5012

BACKGROUND

In the 1984 Deficit Reduction Act, Congress attempted to limit the purchase of life insurance contracts as an investment. Since insurance proceeds receive favorable tax treatment, these contracts were often used as tax-sheltered investments.

However, according to Congress, the 1984 Act did not place strict enough constraints on single premium life insurance contracts. Single premium insurance contracts have three primary benefits:

1. Undistributed investment income earned on premiums which qualify as life insurance is not currently taxed,
2. Death benefits paid under a life insurance contract are excluded from gross income, and
3. Amounts received under a life insurance contract before death of the insured are not included in income to the extent that the amount received is less than the investment.

This favored tax treatment for the insurance industry has met with hard criticism. Other tax-sheltered program (i.e. mutual funds and certificates of deposit) have been subject to legislation which reduces their tax-favored status. Also, many insurance contracts are not subject to penalties and restrictions on withdrawals and contributions that apply to other tax-favored savings plans.

CURRENT CALIFORNIA LAW (Sec. 17039, 17085, 23036 and 24272.2)

California has no provision relating to "modified endowment contracts". However, California is in conformity with federal law relating to life insurance contracts as well as rules for distributions of annuity contracts and penalties for premature distributions. The California penalty on premature distribution of annuities is 2 1/2 percent versus the federal 10 percent penalty.

NEW FEDERAL LAW (Sec. 26, 72 and 7702A)

As a result of the criticism, Congress enacted a new provision which focuses on the treatment of monies received under a life insurance contract prior to the death of the insured, known as "Modified Endowment Contracts". These contracts are generally purchased primarily as an investment rather than as life insurance.

Definition

Under the new provision Congress defines modified endowment contracts as those whose premium payments are greater that the amount needed to fund a defined level of future death benefits. Specifically, a modified endowment contract is any contract that satisfies the present-law definition of a life insurance contract, but fails to satisfy the "7-pay test". In order to satisfy the 7-pay test, a contract must provide greater insurance protection per premium dollar than is required to meet the definition of an insurance contract. Modified endowment contract also includes any contract that is received in exchange for a modified endowment contract.

Distribution Rules

If an insurance contract is classified as a modified endowment contract, amounts received under the contract are treated first as income and then as recovered basis. Amounts received under the contract that are greater than the excess of the cash surrender value of the contract over the taxpayer's investment are treated as a return of capital and reduces the taxpayer's investment in the contract.

Loans under the contract (and loans secured by that contract) are treated as amounts received under the contract. An exception is provided where an assignment or pledge was made solely to cover payment of burial expenses if the maximum death benefit under the contract is $25,000 or less.

In determining whether amounts payable or borrowed under the contract are considered as a distribution, only amounts in the nature of a dividend that is retained by the insurer as a premium are not included in the gross income of the contract owner.

10 Percent Additional Tax

A 10 percent additional tax is imposed on the amount that is includible in gross income as a distribution from a modified endowment contract in the taxable year. However, the additional tax is not applicable to any distribution:

1. Made on or after the date on which the taxpayer becomes age 59 1/2,

2. Which is attributable to the taxpayer's becoming disabled, or

3. Which is part of equal periodic payments (not less frequent than annual) made for the life expectancy to the taxpayer or the joint life expectancy of such taxpayer and the beneficiary.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions apply to contracts entered into, or materially changed, on or after June 21, 1988.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, comparable revenue gains for California would be in the $4 million range for 1989-90 and the $7 million range for 1990-91. These estimates include the minor effect of Act Section 5011 (mortality and expense charge limitations for life insurance contracts).

TITLE V: Revenue Increase Provisions

SUBTITLE B: Insurance Provisions

ACTION: DELETES SPECIAL VALUATION OF GROUP TERM LIFE INSURANCE PROVIDED INDIVIDUALS OVER 63

Act Section 5013

BACKGROUND

In general, the cost of group term life insurance which is carried by an employer is determined by a standard rate table (see below), which is prescribed by regulation and in which the premium value is determined by an individual's age, increasing in 5 year increments.

Using this method, the cost of insurance provided an individual 64 years of age or older is valued at the same standard premium rate as an individual 63 years of age. (Since the insurance cost table utilized is structured in 5 year brackets, it is individuals over age 64 who actually receive special treatment). As a result, the value of life insurance carried by an employer for an individual over the age of 63 tends to be undervalued.

Because the value of group-term life insurance determined by this method, and hence the amount which may be required to be included in an individual's gross income for tax purposes, is less than the age-related value of the insurance provided individuals over the age of 64, the present law benefits older individuals who are provided group-term life insurance by their employer. Since Congress did not identify a policy rationale which justifies the special treatment of employer-provided life insurance costs for individuals over age 63, this act repealed the special rule for individuals over the age of 63, and the standard premium rate table will be revised to include brackets for over the age of 64.

CURRENT CALIFORNIA LAW (Sec. 17081)

California and federal law, relating to the value of employer-provided group-term life insurance which must be included in an individual's gross income for tax purposes, are the same.

Under current law, the cost of group-term life insurance carried by an employer must be included in an individual's gross income to the extent that the cost is related to the proceeds of the policy which are in excess of $50,000. In addition, highly compensated employees must include the value of employer-provided life insurance to the extent that insurance is provided to those employees on a discriminatory basis.

The age-related premium value of insurance is prescribed by regulation, and is reflected in a standard rate table. However, the premium value of insurance provided a person who is over the age of 63 is determined as if the individual is 63.

Current Group-Term Life Insurance Table

Cost per $1,000 of protection for a 1 month period

5 yr. age bracket

Under 30	$0.08
30 to 34	.09
35 to 39	.11
40 to 44	.17
45 to 49	.29
50 to 54	.48
55 to 59	.75
60 to 64	1.17

In addition, current law includes grandfather clauses for life insurance policies in existence on January 1, 1984 and covering former employees who were retired or who had attained age 55, without regard to whether the policy exceeds $50,000.

NEW FEDERAL LAW (Sec. 79(c))

This section of the act revises the determination of the cost of group-term life insurance provided by an employer, by repealing the rule which measures the age-related premium value of insurance provided for a person over 63 at the same rate the value is computed for insurance provided an individual 63 years of age. As a result, the standard premium value rate table which is structured in five year increments, will be revised to include age brackets over 64.

However, individuals eligible for treatment under the grandfather clauses related to the 1984 Deficit Reduction Act will continue to retain their eligibility.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendments contained in this section of the act apply to tax years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, base-line revenue gains under the Personal Income Tax Law would be minor, in the $500,000 range annually. This impact results from federal legislation.

TITLE V: Revenue Increase Provisions

SUBTITLE C: Loss Transfer Rules for Alaska Native Corporations

ACTION: REPEAL SPECIAL NOL RULES APPLICABLE TO THESE CORPORATIONS

Act Section 5021

BACKGROUND

The 1986 Tax Reform Act in a noncode provision permits Alaska Native Corporations to transfer unused credits or operating losses to other corporations.

CURRENT CALIFORNIA LAW

California did not conform to this 1986 Tax Reform Act noncode provision.

NEW FEDERAL LAW (noncode provision)

TAMRA repeals these special rules which are applicable only to Alaska Native Corporations.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This section applies to losses and credits which arise after April 26, 1988. This section does not apply to any loss or credit of a corporations if such corporation was in existence on April 26,1988, and the loss or credit is used to offset income assigned in accordance with a binding contract entered into before July 26, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE V: **Revenue Increase Provisions**

SUBTITLE D: **Estate and Gift Tax Provisions**

ACTION: REQUIRES AN UPDATE OF VALUATION TABLES FOR ANNUITIES, LIFE ESTATES, TERMS FOR YEARS, REMAINDER AND REVERSIONARY INTEREST

Act Section 5031

BACKGROUND

The Internal Revenue Service publishes tables to be used to value annuities, interests for life or terms for years, or remainder or reversionary interests. The Internal Revenue Service has proposed amendments to the regulation under those code sections that deal with the valuation of annuities, life estates, terms for years, remainder or reversionary interests, which provide gender-neutral mortality tables. These proposed regulations, which are based on assumed rate or return of 10 percent, rather that six percent, became effective after November 30, 1983. The last published Internal Revenue Service tables in 1984, use a 10 percent interest rate and are based on mortality assumptions published in 1969 through 1971.

Congress enacted a new provision to reflect a more accurate valuation method. Under the new provision, the Internal Revenue Service is required to publish new tables reflecting the most up-to-date mortality experiences using a rate equal to 120 percent of the federal mid-term rate (generally the average rate of federal marketable obligations with remaining periods of more than three but less than nine years). Also, the Internal Revenue Service must revise the tables at least once every 10 years.

CURRENT CALIFORNIA LAW (Sec. 17731)

California conforms with the federal code section dealing with the valuation of annuities, life estates, terms of years and remainder or reversionary interests.

NEW FEDERAL LAW (Sec. 7520)

Under the new provision, the value of any annuity, any interest for life or a term for years, or any remainder or reversionary interest shall be determined as follows:

1. under tables prescribed by the Secretary, and

2. by using an interest rate (rounded to the nearest 2/10ths of one percent) equal to 120 percent of the federal mid-term rate in effect under section 1274(d)(1) for the month in which the valuation date falls.

If an income, estate, or gift tax charitable contribution deduction is allowable for more than an insignificant part of the property transferred, the taxpayer may elect to use such federal mid-term rate for either of the two months preceding the valuation date.

The new provision does not apply to interests valued with respect to qualified plans or in other situations specified in Treasury Regulations.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to interests valued on or after May 1, 1989.

STATE REVENUE IMPACT

The Joint Committee on Taxation has estimated revenue gains for the nation of less than $10 million annually. Comparable state revenue gains would be minor, in the $250,000 range annually.

TITLE V: Revenue Increase Provisions

SUBTITLE E: Long-Term Contracts

ACTION: CHANGES THE PERCENTAGE OF COMPLETION-CAPITALIZED COST METHOD OF COMPUTING INCOME FROM LONG-TERM CONTRACTS

Act Section 5041

BACKGROUND

The federal Tax Reform Act of 1986 (P.L. 99-514) added Internal Revenue Code Section 460, establishing a new method of accounting for contracts which take more than one year to complete (long-term contracts). For contracts entered into after February 28, 1986, a taxpayer must use either the percentage of completion method of accounting, which brings into income and deducts as expenses amounts based on the percentage of the contract which has been completed during the year, or a hybrid method called the "percentage of completion capitalized-cost method". That hybrid method provides that 40 percent of items (income and expenses) with respect to a long term contract must be reported under the percentage of completion method, while the remaining 60 percent of the items with respect to the contract must be taken into account under the taxpayer's normal method of accounting (such as the completed contract method which defers the reporting of items until the year the contract is completed).

The federal Revenue Act of 1987 (P.L. 100-203) changed the percentage of completion-capitalized cost method for contracts entered into on or after October 13, 1987, requiring that 70 percent be taken into account currently and 30 percent be taken into account under the taxpayer's normal accounting method. An exception to this change is provided for certain "qualified ship contracts". Consistent with this new rule, the calculation of interest for underpayments and overpayments with respect to these contracts during a "look-back period" will be based on 70 percent of the items taken into account under the percentage of completion method.

CURRENT CALIFORNIA LAW (Sec. 17551 and 24673.2)

California adopted the federal TRA-1986 provisions by reference in Section 17024.5 (AB 53, Stats. 1987, Ch. 1138) and Section 24673.2 (SB 572, Stats. 1987, Ch. 1139); and further modified Section 24673.2 by requiring, upon completion of a contract entered into after February 28, 1986 during an income year beginning before January 1, 1987, that an adjustment to income be made to correct any underreporting or overreporting of income resulting from differences between state and federal law for the income year in which the contract began (AB 2130, Stats. 1988. Ch. 11).

California has not statutorily conformed to the 70%-30% change made in the percentage of completion-capitalized cost method by the federal Revenue Act of 1987, nor has California conformed to the 90%-10% change enacted by the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-627) (see below); but administratively, to maintain consistency in accounting for state and federal purposes, will allow taxpayers to use the federal percentages, as specified above, rather than the 40%-60% statutory division.

NEW FEDERAL LAW (Sec. 460 and 56(a)(3))

For long-term contracts (other than qualified ship contracts) generally executed after June 20, 1988, current recognition of income and expenses under the percentage of completion-capitalized cost method of accounting is raised from 70 percent to 90 percent. Thus, items deferred (taken into account under the taxpayer's normal method of accounting such as the completed contract method, etc.) are reduced from 30 percent to 10 percent. However, this change does not apply to any contract resulting from the acceptance of an irrevocable bid made before June 21, 1988.

Home construction contracts exception. Neither the percentage of completion method nor the percentage of completion-capitalized cost method of accounting applies to "home construction contracts". Instead, the uniform capitalization rules apply to home construction contracts. "Home construction contracts" are contracts where at least 80% of the estimated total costs to be incurred under the contract are attributable to dwelling units in a building with four or fewer dwelling units. For this purpose, each townhouse or row house is treated as a separate building.

The percentage of completion-capitalized cost method of accounting must be used for those residential construction contracts that do not qualify as "home construction contracts", but is modified to use a 70% current recognition/30% deferral rule rather than the 90%/10% rule.

Simplified look-back method. When a long-term contract reported under the percentage of completion method is completed, a determination is made concerning whether the taxes paid regarding such contract for each year of the contract were more or less than the amount that would have been due if gross income had been computed using the actual total contract price and the actual total contract costs, rather than the anticipated contract price and costs.

Pass-through entities (partnerships, S corporations, and trusts) that are not closely held must apply the new simplified look-back method if substantially all of the income under a long-term contract is from sources within the United States. A closely held entity is an entity where 50% or more of the value of the beneficial interests are owned by five or fewer persons. The amount of taxes deemed overpaid or underpaid under a contract in any year is determined at the entity level and is the product of the amount of contract income overreported or underreported for the year times the top marginal tax rate applicable for the year (the top corporate tax rate, or the top individual tax rate if more than 50% of the beneficial interests in the entity are held by individuals). Interest required to be paid on any underpayment of tax shall be paid by the entity, and interest entitled to be received on any overpayment of tax shall be paid to the entity. The simplified look-back method generally applies to contracts executed after February 28, 1986, except for contracts completed in a tax year for which the due date of the return (including extensions) is before November 10, 1988, the date of enactment of TAMRA.

Alternative minimum tax. In determining the alternative minimum taxable income for purposes of computing alternative minimum tax liability, "home construction contracts" of small contractors are not considered long-term contracts. Thus, such contracts are not subject to the alternative minimum tax. Such contracts include "home construction contracts" that are estimated to be completed within two years after the contract commencement date and are entered into by a taxpayer who has average annual gross receipts for the three tax years preceding the tax year in which the contract is executed that do not exceed $10 million.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Changes in the percentage of completion-capitalized cost method apply to contracts entered into on or after June 21, 1988; except for qualified ship contracts, and for contracts resulting from the acceptance of an irrevocable bid made before June 21, 1988.

The simplified look-back method applies to contracts entered into after February 28, 1986.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation and a prior analysis by the Policy Economics Group, state revenue gains are estimated to be in the $73 million range for 1989-90 and the $77 million range for 1990-91. These estimates reflect increasing the current state requirement from 40% to 90% for the portions of the contract required to be computed under the percentage of completion method.

TITLE V: Revenue Increase Provisions

SUBTITLE F: Tax-exempt Bond Provisions

ACTION: IMPOSES NEW REQUIREMENTS ON PRIVATE ACTIVITY BONDS AS A CONDITION OF TAX EXEMPTION

Act Section 5051

BACKGROUND

Generally, for federal purposes interest on State and local government bonds is tax-exempt if the bonds are issued to finance governmental activities. However, if the bonds are issued to finance private activities for the benefit of the general public, the interest is taxable unless there exists a specific exception outlined in federal law.

One of the exceptions in federal law is for pooled financing bonds. A pooled financing bond is defined as any bond issue where an amount exceeding the lesser of five percent or $5 million of the issue proceeds are reasonably expected, at the time of issue, to be used directly or indirectly to finance loans to two or more borrowers.

Recently, Congress has found that some governmental units have increased their issues of tax-exempt bonds when no current financing was needed, solely as a hedge against a possible rise in interest rates. Congress enacted a new provision in order to establish a statutory provision for the identification of the ultimate borrowers at the time of issue, and a statutory restriction which relates to the period in which the loans must originate.

CURRENT CALIFORNIA LAW

California does not have a provision which relates directly to the tax-exempt treatment of pooled financing bonds. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW

The new provision imposes two requirements that must be met in order for pooled financing issues to be tax exempt.

Reasonable Expectation Requirement

This requirement is satisfied in regards to an issue if the issuer reasonably expects that as of the close of the three-year period beginning on the date of issuance, at least 95 percent of the net proceeds of the issue will have been used directly or indirectly to make or finance loans to ultimate borrowers. As for refunding bonds, the three-year period begins on the date of issuance of the refunded bond.

"Net proceeds" are the proceeds of the issue reduced by amounts in a reasonably required reserve or replacement funds. However, the proceeds do not include proceeds used to finance costs or to pay interest during the three-year period.

Changes in the interest rates, the Code, IRS regulations, and IRS rulings may not be used as a basis for "reasonable expectations".

Cost of Issuance Payment Requirement

This requirement is satisfied in regards to an issue if:

1. the payment of legal and underwriting costs associated with the issuance of the issue is not contingent, and

2. at least 95 percent of the reasonably expected legal and underwriting costs are paid no later than the 180th day after the date of issuance.

EFFECTIVE DATE OF FEDERAL PROVISIONS

In general, the provision applies to bonds issued after October 21, 1988. However, there is a special rule for refunding bonds. In the case of a bond issued to refund a bond issued before October 22, 1988 the following rules apply:

1. The three-year period requirement, which would normally have expired on or before October 22, 1989, will expire on October 21, 1990.

2. For bonds expiring after October 22, 1989, the portion of the proceeds of a refunding issue, which is available to provide loans, will be treated as proceeds of a separate issue subject to the requirements of the new provision.

STATE REVENUE IMPACT

Not applicable.

TITLE V: Revenue Increase Provisions

SUBTITLE G: Excise Tax Provisions

ACTION: IMPOSITION AND MODIFICATION OF EXCISE TAX PROVISIONS

Act Section 5061, 5063 and 5072

BACKGROUND

The federal government imposes numerous excise taxes either as direct taxes or as penalty provisions throughout the Internal Revenue Code.

CURRENT CALIFORNIA LAW

The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not impose excise taxes nor a tax on the reversion of pension plan assets.

NEW FEDERAL LAW

TAMRA imposes an excise tax on manufacture or importation of pipe tobacco and modifies the excise tax on distilled spirits. In addition, under TAMRA the excise tax imposed on employers upon the reversion to the employer of pension plan assets is made due on the last day of the month following the month in which the reversion occurs.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions relating to distilled spirits take effect November 10, 1988 the tobacco provision starts January 1, 1989 and the modification to the employer reversion tax applies to reversions after December 31, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE V: Revenue Increase Provisions

SUBTITLE A: Other Revenue Increase Provisions

ACTION: INCREASE PENALTY FOR BAD CHECKS

Act Section 5071

BACKGROUND

The Internal Revenue Service (IRS) is authorized to impose a penalty for dishonored checks. The penalty (which was 1% of the amount of the check, except that if the check amount was less than $500, then the penalty was the lesser of $5 or the amount of the check) had not been changed since 1954.

CURRENT CALIFORNIA LAW AND PRACTICE

Section 6157 of the Government Code authorizes the State to charge a reasonable amount not to exceed $10 for dishonored checks. The charge may be added to and become part of the underlying obligation.

According to the State Administrative Manual (SAM) (Section 8043.1) and the Department of Finance, this charge must be accounted for so that upon collection it can be transferred to the General Fund.

The Franchise Tax Board does not currently assess this charge. However, the suggestion to impose the charge has been taken under consideration several times in the past. Employees have suggested imposition of the charge several times through the merit award program. The main reasons cited for rejecting the suggestion in March of 1988 was that the: (1) benefit of additional revenue would be diminished by the cost of developing a computer accounting program to track the charge/payment so that it could be transferred to the General Fund, and (2) potential increase in workload for public service staff.

NEW FEDERAL LAW (Sec. 6657)

The bad check penalty imposed by the IRS, in general, is increased from 1 percent to 2 percent of the amount of the check. For a check amount under $750 the minimum amount of the penalty is increased from $5 to $15 (or amount of check, if less than $15).

This provision was added as a revenue raiser to ensure that the bill is revenue neutral through fiscal year 1991 (Tax Notes; Volume 40, Number 4; Congressional Reports, page 432).

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for checks received by the IRS after November 10, 1988.

STATE REVENUE IMPACT

Not applicable due to cost and workload considerations. The Department has administratively declined to impose the dishonored check charge authorized under current state law.

TITLE V: Revenue Increase Provisions

SUBTITLE H: Other Revenues Increase Provisions

ACTION: DENY DEDUCTIONS FOR CERTAIN RESIDENTIAL TELEPHONE SERVICES

Act Section 5073

BACKGROUND

Employers and employees are allowed business expense deductions. Both have specific rules that must be followed in order to claim business expense deductions. Generally, business expense deductions are allowed for employers and employees to the extent that the expense directly relates to business.

EMPLOYERS

Employers are allowed business expense deductions for ordinary and necessary expenses directly connected with the employer's trade, business or profession. Employers who use part of their homes for business are allowed the same business expense deductions provided that a specific part of the residence is set aside and used exclusively on a regular basis as (1) the principal place of any business, or (2) a place where the taxpayer meets with patients, clients or customers.

A few of the items that may be included as part of these "home-office" business expense deductions are costs for telephones, computers, equipment, utility expenses, and space in the home.

The amount of expense that can be deducted by the taxpayer depends on the proportion of the expense that was actually incurred because of the taxpayer's business. For example: If the average electric bill for the home was $200 a month and the amount of business activity that contributed to the expense was determined to be 20%, then the amount of the allowable deduction would be $480 (12 months x $200 x .20 = $480). The $480 deduction would be subtracted directly from the taxpayer's business income.

EMPLOYEES

Employees are allowed to deduct expenses incurred during the course of employment, however, whether the expense was reimbursed by the employer or not determines the manner in which the employee may deduct the expense.

Expenses that have been reimbursed by the employer and included in the employee's gross income, which have not been treated as wages subject to withholding, are allowed to be deducted directly from the employee's gross income.

Expenses that are not reimbursed or the portion of an expense in excess of the amount reimbursed by the employer are deductible only as a miscellaneous itemized deduction. This means that only the taxpayer's cumulative miscellaneous itemized deductions that exceed 2% of the taxpayer's adjusted gross income are allowed as the deduction.

Effective for tax years beginning after 1988, for federal purposes employee business expense deductions may generally not be deducted from gross income if the reimbursement arrangement with the employer (1) does not require the employee to substantiate the expenses to the employer or (2) allows the employee to keep the excess reimbursement. Thus, as a general rule, reimbursed but unsubstantiated employee business expenses will be deductible only as miscellaneous itemized deductions subject to the 2% limitation.

CURRENT CALIFORNIA LAW (Sec. 17201)

Current California law conforms to federal law by allowing a business expense deduction for all telephone charges proportionate to the percentage of use that is attributable to any business.

For employers, this expense is deducted directly from business income as an adjustment in determining the amount of tax owed. Whereas for employees, unreimbursed expenses and expenses not fully reimbursed along with other miscellaneous itemized expenses must cumulatively exceed 2% of the taxpayer's federal adjusted gross income. Employees may deduct reimbursed business expenses from gross income provided that the employer includes the reimbursement in the employee's gross income and does not treat the reimbursement as wages subject to withholding.

NEW FEDERAL LAW (Sec. 262)

Individuals will not be allowed a deduction for any charge, including any sales or excise taxes, required to be paid by the taxpayer in order to obtain local telephone service for the first telephone line in the taxpayer's residence.

This would not affect the deductibility of equipment, rental, optional services (call-forwarding, conference calling, etc.), long-distance calls or additional telephone lines necessary to the taxpayer's trade or business.

This change was included by the House Ways and Means Committee because it recognized that individuals incur certain charges for having local telephone service provided to their residences for personal use. These charges represents a personal consumption expense, no part of which is deductible by individuals who do not use the telephone in their residence for business purposes. The Committee determined that it is not appropriate to allow a deduction for any part of the charges required to be paid by the taxpayer in order to obtain local telephone service with respect to the first telephone line provided to any residence of the taxpayer merely because the line may also be used for business purposes, since the incurring of such expenses is attributable to personal needs.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This act section is effective for taxable years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, the revenue gain under the Personal Income Tax Law is estimated to be in the $1.1 million range for 1989-90 and $1.0 million range for 1990-91. These estimates assume an enactment date after June 30, 1989.

TITLE V: Revenue Increase Provisions

SUBTITLE H: Other Revenue Increases

ACTION: PARTNERSHIP REPORTING OF UNRELATED BUSINESS TAXABLE INCOME

Act Section 5074

BACKGROUND

Under present law, a partnership generally must furnish to each partner a statement reflecting such information required to be shown on the partnership's return as may be specified by Treasury Regulations. The statement must set forth the partner's distributive share of partnership income, gain, loss deduction, or credit required to be shown on the partnership return, plus any additional information required by Internal Revenue Service forms or instructions. The present statute and regulations do not make an express reference to reporting by partnerships (in which exempt organizations are partners) of that portion of the organization's distributive share of partnership income that is subject to the unrelated business income tax (UBIT).

CURRENT CALIFORNIA LAW (Sec. 17932)

Generally, partnerships are not taxable as such under California law, but are treated as reporting entities only, with the distributive shares of the partners being reported in the same manner as required under federal law, and taxed in the partner's individual returns. However, for post-1987 tax years, the minimum corporation franchise tax for the privilege of doing business in the state has been extended to include limited partnerships.

NEW FEDERAL LAW (Sec. 6031)

The new federal law expressly provides that, in the case of any partnership regularly carrying on a trade or business, the partnership must furnish to the partners such information as necessary to enable each tax-exempt partner to compute its distributive share of partnership income or loss from such trade or business.

By expressly expanding the statutory language relating to specific reporting of income subject to the UBIT, the conferees believe that emphasis will be placed on the enforcement by the IRS of reporting requirements.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This change is effective for taxable years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Any additional revenues received by California from tax-exempt partners due to this federal reporting requirement would be very minor. Federal estimates show a gain of only $1 million annually.

TITLE V: Revenue Increase Provisions

SUBTITLE H: Other Revenue Increase Provisions

ACTION: OPTIONS SUBJECT TO WASH SALE RULES

Act Section 5075

BACKGROUND

Generally the wash sale provisions deny the deduction of a loss on the sale or other disposition of shares of stock or securities if the taxpayer acquires or enters into a contract or option to acquire substantially identical stock or securities within a period beginning 30 days before the date of the sale or other disposition and ending 30 days after that date. A recent Tax Court decision, however, held that the wash sale rules do not apply to deny losses sustained on the sales of stock options.

CURRENT CALIFORNIA LAW (Sec. 18031 and 24998)

California law is conformed to the federal provisions in that losses on the disposition of stock or securities are disallowed where substantially identical property is acquired within 30 days before or after the sale.

NEW FEDERAL LAW (Sec. 1091)

The new federal law extends the wash sale provisions to apply to contracts or options to sell stock or securities, as well as the sale of the actual stock or securities.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to any sale after November 10, 1988, in taxable years ending after that date.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains are estimated to be in the $1 million range for 1989-90, decreasing to the $200,000 range thereafter.

TITLE V: Revenue Increase Provisions

SUBTITLE H: Other Revenue Increase Provisions

ACTION: INTEREST CHARGE ON INSTALLMENT SALES OF CERTAIN PROPERTY

Act Section 5076

BACKGROUND

The Omnibus Budget Reconciliation Act of 1987 provided special installment sale rules that apply to the sale of nonfarm real property that is used in a taxpayer's trade or business or that is held for the production of rental income where the selling price of such real property is greater than $150,000. First, an interest charge is imposed on the tax that is deferred under the installment method to the extent attributable to the amount by which the deferred payments arising from all dispositions of such real property during any year exceeds $5 million. Second, if any indebtedness is secured directly by an installment obligation that arises out of the disposition of such property, the net proceeds of the secured indebtedness is treated as a payment on such installment obligation.

CURRENT CALIFORNIA LAW (Sec. 17551 and 24667)

California law does not provide for the imposition of an interest charge on the tax that is deferred under the installment method, nor does California require that the net proceeds of a secured indebtedness be treated as a payment on the installment obligation in the case where the installment obligation arose out of the disposition of such property.

NEW FEDERAL LAW (Sec. 453A)

The new federal law extends the special installment sale rules contained in the 1987 Act to real and personal property with a sales price in excess of $150,000, whether or not used for business or rental purposes. An exception is retained for property used or produced in the trade or business of farming, and timeshares and residential lots with respect to which interest is paid.

Thus, an interest charge is imposed on the tax that is deferred under the installment method to the extent attributable to the amount by which the deferred payments arising from all dispositions of such property during any year exceeds $5 million. In addition, if any indebtedness is secured directly by an installment obligation that arises out of the disposition of such property, the net proceeds of the secured indebtedness are treated as a payment on the installment obligation.

As under present law, in determining whether the sales price of property exceeds $150,000, all sales or exchanges that are part of the same transaction or series of transactions are treated as a single sale or exchange.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to dispositions that occur after December 31, 1988, except that the provision does not apply to dispositions occurring on or before December 31, 1990, which are pursuant to:

1. A binding written contract that was in effect on October 21, 1988, and at all times thereafter until the disposition occurred; or,

2. A letter of intent or approval by the board of directors or shareholders of either party to the transaction, in effect on or before October 21, 1988.

STATE REVENUE IMPACT

California has not conformed to the 1987 Federal Act installment sale provisions which were estimated to produce state revenue gains of approximately $200 million over the first three years. Should California conform to the 1987 provisions, the extensions contained in the 1988 Act would result in additional revenue gains of perhaps $1 million annually.

TITLE V: Revenue Increase Provisions

SUBTITLE H: Other Revenue Increase Provisions

ACTION: REVISIONS OF NET OPERATING LOSS PROVISIONS RELATING TO ACQUISITIONS

Act Section 5077

BACKGROUND

The changes made by the Tax Reform Act of 1986 to IRC Section 382 impacted the ability of corporations to acquire another corporation and use its net operating loss (NOL) and placed limitations on the amount of loss which could be utilized by the acquiring corporation.

In order for these new NOL provisions to apply, there must be a change in ownership of more that 50% of stock value of a loss corporation (a corporation with NOLs). If this change in ownership occurs, then the NOL carryovers of the loss corporation are eliminated unless the corporation satisfies the continuity-of-business enterprise requirement.

If the continuity-of-business requirement is met, the NOLs of the loss corporation can be used; however, an annual limitation is placed on the amount of loss that can be used.

This limitation is called the Section 382 limitation. It is computed by multiplying the fair market value (FMV) of the loss corporation's stock by the long-term tax-exempt rate. (The long-term tax-exempt rate used is the highest of the adjusted federal long-term rates in effect during the month the stock change occurs and the preceding two calendar months.)

The Section 382 limitation may be adjusted by built-in gains, the holding of substantial investment assets, or by capital contributions made shortly before the ownership change.

Ownership Changes

There is an ownership change if immediately after any ownership shift involving a 5 percent shareholder or any equity structure shift, the percentage of the new loss corporation owned by one or more 5 percent shareholders has increased by more that 50 percentage points over the lowest percentage of stock of the old loss corporation owned by those 5 percent shareholders at any time during the testing period.

Ownership Shift Involving a 5 Percent Shareholder

An ownership shift involving a 5 percent shareholder is defined as any change in the respective stock ownership of a corporation that affects the percentage of stock held by a 5 percent shareholder before or after the change.

A 5 percent shareholder is any shareholder that owns 5 percent or more of the stock of a corporation (by value) at any time during the testing period. The holdings of all shareholders who are not 5 percent shareholders are aggregated and treated as if held by one 5 percent shareholder.

Equity Structure Shift

An equity structure shift is defined as any tax-free reorganization within the meaning of Section 368, other than a divisive reorganization or an "F" reorganization. In addition, to the extent provided in regulations, equity structure shift also includes public offerings and some taxable reorganizations.

Continuity-of-Business Enterprise Requirement

The old loss corporation's business must be continued for a two year period subsequent to the change date.

Testing Period

The testing period is a three year period ending on the date of any ownership shift of a 5 percent shareholder.

Built-in Gains

Special rules apply if an old loss corporation has a net unrealized built-in gain or loss at the time of the ownership change.

A built-in gain or loss exists if the FMV of the corporation's assets before an ownership change is more or less than the aggregate adjusted basis of those assets. The Section 382 limitation is increased by recognized built-in gains and decreased by recognized built-in losses.

In order for a corporation to have a built-in gain or loss, the gain or loss must exceed 25 percent of the FMV of these assets.

Attribution Rules

The attribution rules of Section 318 apply, as follows, in determining ownership of stock.

The stock owned by a corporation is treated as being owned proportionately by its shareholders. Stock owned by a corporation's shareholders is not attributed to the corporation. Family attribution rules do not apply, but certain immediate family member are treated as a single shareholder (i.e. spouse, children, parents, and grandparents).

An option holder is treated as owning the underlying stock if such a presumption would result in an ownership change.

The Bankruptcy Exception

The limitation of the use of losses imposed by this section do not apply to ownership changes if the old corporation was under a bankruptcy court's jurisdiction before the ownership change and its shareholders and creditors immediately before the change own 50 percent or more of the new corporation's stock immediately after the change.

CURRENT CALIFORNIA LAW (Sec. 24592)

California law is conformed to federal law for years beginning on or after January 1, 1987.

NEW FEDERAL LAW (Sec. 382(l)(3)(C)(ii))

Under present law, in determining if a change in ownership has occurred, stock acquired by an employee stock ownership plan (ESOP) is not taken into account if certain requirements are met.

The Act added an additional requirement that must be met for this stock not to be taken into account. The ESOP that acquires the stock must have as its participants no less than 50 percent of the average number of employees employed by the old loss corporation during the testing period.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for acquisitions occurring after December 31, 1988 except those that occur pursuant to a binding written contract entered into on or before October 21, 1988.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be rather minor, in the $500,000 to $1 million range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: LIMITS CONTRIBUTIONS IN CONNECTION WITH ATHLETIC EVENTS

Act Section 6001 and 1016(b)

BACKGROUND

Generally, a deduction for a charitable contribution is only allowed when the taxpayer receives no specific personal benefit from that contribution. Act Section 1608 of the Federal Tax Reform Act of 1986 (P.L. 99-514) (a noncode provision) provided that charitable contributions made in taxable years beginning on or after January 1, 1984 to the University of Texas or Louisiana State University, which would otherwise qualify as a charitable contribution within the meaning of IRC Section 170, would not be disqualified because the taxpayer receives the right to seating or the right to purchase seating in athletic events of those institutions.

CURRENT CALIFORNIA LAW (Sec. 17201 and 24357)

California did not adopt this federal TRA-1986 noncode provision.

NEW FEDERAL LAW (Sec. 170(m))

This Act section amends federal law by repealing the TRA-1986 noncode provision and enacting new code language providing that if a taxpayer makes a payment to or for a college or university that would be deductible as a charitable contribution but for the fact that the taxpayer thereby receives (directly or indirectly) the right to purchase seating at an athletic event in the institution's athletic stadium, 80 percent of such payment is treated as a charitable contribution. This rule applies whether or not the tickets would have been readily available to the taxpayer without making the payment.

No amount paid for the actual purchase of tickets is deductible as a charitable contribution. If the taxpayer receives tickets or seating (rather than the right to purchase tickets) the amount of the payment must be reduced by the value of the tickets prior to applying the 80% rules.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The Act provides retroactive application and will apply to tax years beginning after December 31, 1983. In addition, the statute of limitations for closed years (after 1983) is waived if the taxpayer files a refund claim on or before November 10, 1989, (i.e., within one year of the date of enactment of this provision).

STATE REVENUE IMPACT

National estimates developed by the Joint Committee on Taxation indicate very minor revenue <u>losses</u>; revenue <u>losses</u> under state conformity would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: NONRECOGNITION OF GAIN ON SALE WHERE ONE SPOUSE DIES BEFORE OCCUPYING NEW RESIDENCE

Act Section 6002

BACKGROUND

A married couple filing a joint income tax return generally may defer the recognition of gain on the sale of their principal residence provided that the proceeds from the sale of the old residence are reinvested in a new principal residence within a certain period of time.

CURRENT CALIFORNIA LAW (Sec. 18031)

California conforms to the federal tax treatment regarding rollovers of gain on the sale of a taxpayer's principal residence when one spouse dies.

Currently the rollover of gain on the sale of a principal residence is denied to a surviving taxpayer when both taxpayers have not yet resided in the new residence. This is due to two requirements established under law.

The taxpayer and his/her spouse must (1) occupy the old and new residence as their principal residence and (2) the proceeds of the old residence and the adjusted basis of the new residence are allocated between the taxpayer and his/her spouse.

If a married taxpayer dies during the process of selling a principal residence and purchasing a new residence neither of these two conditions can be met by the surviving spouse, thereby disallowing the rollover of the gain.

NEW FEDERAL LAW (Sec. 1034(g))

This Act Section adds a clause that allows the rollover of the gain from the principal residence to the purchase of a new residence even though one of the taxpayers has died. This applies if the taxpayers were married on the date of the spouse's death and the spouse died after the sale of the old residence. In addition, the surviving spouse must (1) consent to the allocation of proceeds (the same as for married taxpayers) and (2) reside in the new residence as the principal residence. The same tax treatment applied to married taxpayers is adopted for a surviving spouse.

This change was included because the House Ways and Means Committee believes that it is inconsistent with the objective of Sec. 1034(g) to deny a surviving spouse the nonrecognition of gain rule merely because the deceased spouse did not live long enough to complete the sale and purchase requirement.

EFFECTIVE DATE

This provision is retroactive and applies to sales and exchanges of old residences on or after January 1, 1985.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, revenue losses under the Personal Income Tax Law would be in the $600,000 range for 1989-90 and the $400,000 range for 1990-91.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: EXCLUDES MEALS SERVED TO CREWS OF:

1. COMMERCIAL VESSELS;
2. OFFSHORE OIL PLATFORMS;
3. SUPPORT CAMPS AND OIL AND DRILLING RIGS LOCATED IN ALASKA;

FROM THE 80 PERCENT LIMITATION ON BUSINESS EXPENSES DEDUCTIONS FOR MEALS AND ENTERTAINMENT.

Act Section 6003

BACKGROUND

Beginning in 1987, in most cases the actual cost of business related meals and entertainment expenses must be reduced by 20 percent before being claimed as a business expense deduction.

The limit on deductions for meals and entertainment expenses which are incurred for business purposes was introduced as a revenue enhancer and as a source of funding for other social programs, since the deduction was widely perceived as a tax benefit which may, in some cases, have been excessive. A common example of this is the public's perception of the "three-Martini business lunch". However, since 1987, various statutory exceptions have been made to the 80 percent limitation.

Since the cost of supplying meals for the employees of commercial vessels and oil and gas platforms and rigs is nondiscretionary and comparatively expensive, Congress considered it appropriate to allow a deduction equal to the full actual food and beverage costs.

CURRENT CALIFORNIA LAW (Sec. 17201, 17270 and 24443)

Section 24443 was added to the Bank and Corporation Tax Law as a result of the enactment of AB 2130 (Stats. 1988 CH. 11). This provision anticipated Section 6003 of TAMRA in allowing a deduction for the full actual cost of food and beverage supplied by corporate employers to the crews of commercial vessels at sea, and oil and gas platforms and drilling rigs located offshore in Alaska. This provision is expressed in the Revenue and Taxation Code as an exception to current federal law.

California's Personal Income Tax Law is currently in conformity with federal law as it relates to the business expense deduction allowed for meals. In many cases, the deduction for business related meals is limited to 80 percent of the actual cost. Exceptions to the 80 percent limitation rule include:

1. expenses that are treated as an employee's compensation for the purpose of withholding tax;

2. reimbursed expenses for services performed for an employer and not treated as compensation for the purpose of withholding tax, or for services performed for a nonemployer which are accounted for;

3. recreational expenses of employees who are not highly compensated;

4. the cost of goods and facilities made available to the public;

5. entertainment sold to the public for adequate consideration;

6. food and beverage which are associated with an employee's fringe benefits which are of minor value and occur infrequently;

7. the cost of a ticket to a charity sporting event.

NEW FEDERAL LAW (Sec. 274(n))

IRC Section 274 (n) is amended to expand the list of meal expenses which are exceptions to the 80 percent limit on business deductions to include:

1. meals which are served to the crew members aboard commercial shipping vessels and which are required to be served under Title 46 of the U.S. Code, or which are served aboard vessels which would be subject to the Title 46 meal provisions when operating on the high seas, but which are operating on U.S. inland waterways. This exception does not include fishing or foreign vessels, cruise ships or luxury liners;

2. meals which are provided by an employer to the workers on an offshore oil or gas platform or drilling rig;

3. meals which are provided by an employer to the workers on an oil or gas platform or drilling rig in Alaska or a support camp in proximity and integral to an oil or gas platform or drilling rig located in Alaska.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The exception to the 80 percent limitation rule for meals served aboard vessels and which are required by provisions of Title 46 of the U.S. Code apply to tax years beginning on or after January 1, 1989.

The exception to the 80 percent limitation rule for meals provided for the workers on offshore oil and gas platforms and drilling rigs and for the workers on oil and drilling rigs and support bases located in Alaska apply to tax years beginning on or after January 1, 1988.

STATE REVENUE IMPACT

Based on the low level of revenue <u>losses</u> projected for the nation by the Joint Committee on Taxation, revenue <u>losses</u> under the Personal Income Tax Law would be very minor, probably less than $100,000 annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: EXTEND RELIEF FOR INNOCENT SPOUSES TO CERTAIN INDIVIDUALS

Act Section 6004

BACKGROUND

The Tax Reform Act of 1984 (TRA 84) liberalized the innocent spouse relief provisions by expanding the circumstances in which relief may be granted. In addition, the TRA 84 prohibited the use of community property laws in making the determination of responsibility for the understated tax liability.

The authority to disregard community property laws applies to taxable years beginning after December 31, 1984. The remainder of the relief provision is operative for all open years.

CURRENT CALIFORNIA LAW (Sec. 18402.9)

California provides tax relief for innocent spouses which, in general, conforms to the federal provision.

NEW FEDERAL LAW (Act Sec. 6004; not Amending the Code)

This noncode provision extends retroactive relief to an individual regardless of whether he or she was previously denied innocent spouse relief (under IRC Section 6013(e)). Under this act, if:

1. in signing the return he or she did not know, and had no reason to know, that there was an understatement of tax as the result of an unallowable deduction which exceeded the tax shown on the return and

2. the marriage between the spouses, who filed their joint return before January 1, 1985, was terminated and immediately after the termination the net worth of the innocent spouse was less than $10,000.

According to information in "Tax Notes" (Volume 37, Number 5, Page 527), this provision is to benefit a specific unidentified taxpayer in an unknown location. The revenue loss was estimated to be less than $1 million for 1988-90 period.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for joint returns filed before January 1, 1985.

STATE REVENUE IMPACT

Deferred. Only one taxpayer may be affected.

POLICY ISSUES

1. This provision provides retroactive relief.

2. This provision benefits only one taxpayer in the United States who may or may not be a California resident. If a Californian, it is likely that a bill would already have been or will be introduced to provide equivalent relief under state law.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: ALLOWS FOR THE NON-TAXED TREATMENT OF THE CHRISTA MCAULIFFE FELLOWSHIP AWARDS

Act Section 6005

BACKGROUND

Under the Christa McAuliffe Fellowship Program, the Federal government awards fellowships annually to outstanding teachers. The fellowship award may be used for an education improvement project approved by the Department of Education. These projects can range from developing special innovative projects to sabbaticals for study, or research, or academic improvement.

Under the program, a recipient's award cannot exceed the average national salary of a public school teacher. If a recipient does not return to teaching in his or her school district within two years of the fellowship, the award received must be repaid. Currently, checks are issued directly to the teacher on a basis of a monthly budget needed in order to carry out the approved project.

Ideally, the fellowship is for the benefit of the school district rather than the individual. The federal statute which established the Christa McAuliffe Fellowship Program did not include rules for the Federal income tax treatment of program awards. Therefore, as provided under the Tax Reform Act of 1986, nonscholarship awards received by individuals are includible in the recipient's gross income.

The federal statue which established the fellowship not intend for this fellowship to be considered income to the recipient so Congress has enacted a new exclusion in this Act.

CURRENT CALIFORNIA LAW (Sec. 17131)

California conforms to federal law in that prizes and awards are specifically designated as being includible in taxable income.

NEW FEDERAL LAW (noncode provision)

Under the Act language, a teacher who received the Christa McAuliffe Fellowship Award is not required to include the amount received in his or her gross income as long as the award is directly used for the benefit of a school or school district.

However, if the recipient uses the award for personal use (i.e. compensation for services or sabbatical leave), the amount of the award must be included in the recipient's gross income.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to amounts received prior to July 1, 1990 in taxable years beginning before such date.

STATE REVENUE IMPACT

The Joint Committee on Taxation estimates revenue losses for the nation of less than $500,000 annually. State revenue losses, if any, would be very minor.

TITLE IV: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: ALLOWS CERTAIN UNEARNED INCOME OF MINOR CHILDREN TO BE INCLUDED ON PARENT'S RETURN

Act Section 6006

BACKGROUND

Prior to the Tax Reform Act of 1986, a family was able to reduce its tax liability by shifting income-producing property among family members. As a result, a parent could deflect part of the family's income to a child. This transfer would thereby allow the income-producing property of the parent to be taxed at the child's rate, which generally was lower than the parent's rate.

The so called "kiddie tax", enacted by the 1986 Tax Reform Act requires a child under the age of 14 to pay tax at his or her parent's rates on "net unearned income". This applies even if the money or other income-producing property was given to the child before 1987.

If the child is age 14 or older, his or her net unearned income is taxed at the child's rate, not the parent's.

Congress enacted this new provision in order to simplify the filing requirement relating to the taxation of unearned income of children under the age 14. Under this new provision, the parent may elect to include the child's unearned income on the parent's income tax return. As a result, the parent avoids filing a separate return for the child, making estimated tax payments for the child, and incurring additional tax preparation fees. Thus, the child's unearned income increases the parent's adjusted gross income, thereby affecting the floor or ceiling for itemized deductions, medical expenses, and other deductions.

CURRENT CALIFORNIA LAW (Sec. 17041(g) and 17069)

California law is in conformity with the federal law which provided a rule for figuring the amount of income tax for children under 14 years of age, who have over $1,000 of "investment income". Under California law a dependent child with any unearned income must file a tax return if his or her total income exceeds $500. A child's net unearned income in excess of $500, reduced by the child's standard or itemized deductions allocated to such income, is subject to tax at the top marginal tax rate of his or her parents. Since the applicable standard deduction is generally limited to $500, only unearned income of a minor child in excess of $1,000 will be taxed at the parent's rate. This provision applies to children who have not reached age 14 before the close of the tax year and have either parent living at the close of such year. In California this provision is mitigated through the availability of the special low-income tax credit. That credit is a variable percentage of the tax computed on the return and is based on AGI, adjusted annually for inflation.

NEW FEDERAL LAW (Sec. 1(i)(7))

Under the new provision a parent may elect to include on his or her income tax return the unearned income of the dependent child under the age of 14. The following requirements apply:

1. The child's income must be greater that $500 and less than $5,000;

2. Unearned income must consist solely of dividends and interest (including Alaska Permanent Fund dividends);

3. Estimated payments for the year were not made in the child's name and social security number; and

4. Backup withholding has not been made on the child's unearned income during the year.

A parent electing this provision must include the gross income of the child in excess of $1,000 in his or her income. The parent must also report additional tax liability with his or her return equal to the lessor of (1) $75 or (2) 15 percent of the excess of the child's income over $500. If the parent elects this provision, then the child will be treated as having no gross income and is not required to file a tax return.

In addition, any interest of specified private activity bonds is treated as an item of tax preference on the parent's return.

EXAMPLE

Ron is 9 years old and has unearned income of $5,000 from interest and dividends. His parents are in the top marginal tax bracket, which is 28 percent. By adding $4,000 to their income, their additional tax is $1,195 (28% X $4,000 = $1,120 + $75).

If he files his own return, Ron's tax is also $1,195. His standard deduction offsets the first $500. His tax is therefore 15% X $500 = $75 + $1,120 as computed above, or $1,195.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendment to the provision is effective for taxable years beginning after December 31, 1988.

STATE REVENUE IMPACT

Any net revenue impact from a comparable state provision under the Personal Income Tax Law would be negligible. Many taxpayers would not make this election for state tax purposes due to the low-income tax credit.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: ALLOWS AN ABOVE-THE-LINE DEDUCTION FOR JURY DUTY PAY WHEN SURRENDERED TO AN INDIVIDUAL'S EMPLOYER

Act Section 6007

BACKGROUND

If an employer requires its employees to surrender to the employer amounts received as jury duty pay, in return for the employer paying compensation to the employee during jury duty service, then the amount surrendered is deductible only if the employee itemizes deductions. Miscellaneous itemized deductions are deductible only to the extent that they exceed two percent of the employee's federal adjusted gross income.

CURRENT CALIFORNIA LAW (Sec. 17072, 17076 and 17201)

California is in conformity with federal law.

NEW FEDERAL LAW (Sec. 62 and (new) 220)

The new federal law provides a deduction in arriving at adjusted gross income (an "above-the-line" deduction) for the amount of jury duty pay surrendered by an employee to his or her employer, in return for the employer's payment of compensation to the employee for the period of jury service. Because the deduction is "above-the-line", the deduction is available to both itemizers and nonitemizers and is not subject to the 2%-of-adjusted gross income floor on miscellaneous itemized deductions.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to taxable years beginning after December 31, 1986.

STATE REVENUE IMPACT

Based on the very low level of revenue losses estimated for the nation by the Joint Committee on Taxation, state revenue losses would be negligible annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: AUGMENTS THE STANDARD MILEAGE RATE FOR THE BUSINESS USE OF AN AUTOMOBILE BY A RURAL MAIL CARRIER.

Act Section 6008

BACKGROUND

Annually, the Secretary of the Treasury sets the mileage rate which individuals may elect to use to compute expenses for the business use of a privately owned automobile. The rate is based on a data analysis study currently performed by the Wisconsin-based firm of Runzheimer International, under the terms of a five-year contract with the federal government.

Since rural mail carriers are frequently required to use their personal automobiles for U.S. Postal Service work, while travelling over unimproved and poorly maintained roads, their privately-owned vehicles may require extraordinary maintenance and repair measures. For this reason, the national standard mileage rate may not accurately reflect the costs of operating personal vehicles which are incurred by rural mail carriers.

CURRENT CALIFORNIA LAW (Sec. 17260)

California law is generally in conformity with the federal law which regulates the computation of the deduction for employee business expenses. The deduction may include expenses for the use of a privately owned automobile for business purposes. Automobile expenses may be computed by the application of a standard mileage rate which is prescribed annually by the Secretary of the Treasury or the Secretary's delegate. The 1988 standard mileage rate is currently set at 24 cents per mile for the first 15,000 miles of business use, and 11 cents per mile thereafter. The standard mileage rate method of computing vehicle expenses may be used for automobiles which have not been fully depreciated. Actual recorded expenses must be claimed when vehicles have been fully depreciated. Unreimbursed employee business expenses, as well as most other miscellaneous expenses may be deducted only to the extent that they exceed 2 percent of a taxpayer's adjusted gross income.

NEW FEDERAL LAW (Act Sec. 6008 - noncode provision)

This act establishes a general rule which applies to Section 162 (business related) expense deductions. The rule allows U.S. Postal Service employees, who use privately owned vehicles for the delivery and collection of mail on rural routes, to elect to compute automobile expenses at a rate for all mileage travelled equal to 150 percent of the contemporary basic standard mileage rate applicable to the first 15,000 business purpose miles travelled under other circumstances. This option may be elected by rural mail carriers who have not claimed a depreciation deduction for the automobile after December 31, 1987.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This general rule applies to Section 162 for tax years beginning on or after January 1, 1988.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, revenue losses under the Personal Income Tax Law would be minor, in the $100,000 range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: EXCLUSION FROM GROSS INCOME FOR INCOME FROM UNITED STATES SAVINGS BONDS USED TO PAY TUITION AND FEES

Act Section 6009

BACKGROUND

Title XIII of the federal 1986 Tax Reform Act (Public Law 99-514) provided that interest on bonds of the United States, its agencies, or its instrumentalities is fully taxable and interest on state and local bonds of any state and certain industrial bonds is tax exempt.

No special exclusion for interest on Series EE United States saving bonds used to finance higher education was provided.

CURRENT CALIFORNIA LAW

The California Constitution excludes from income interest on bonds issued by California or a local government in California while statutory law excludes from gross income interest the state is prohibited from taxing under the U.S. Constitution and federal law.

This means that interest from U.S. savings bonds is exempt from California taxation. Therefore, this new federal law would not be applicable for California purposes.

NEW FEDERAL LAW (New Sec. 135)

This Act adds a new code provision which excludes from gross income the accrued interest on Series EE United States saving bonds that are redeemed by the taxpayer during the tax year. The exclusion is limited to the aggregate redemption proceeds (principal and interest) which do not exceed the qualified higher education expenses incurred by the taxpayer and his or her family during the same tax year. If the redemption proceeds exceed the qualified higher education expenses, the amount of interest excludable is reduced on a pro rata basis. That is, the accrued interest is multiplied by a fraction, the numerator of which is the amount of qualified higher education expenses, and the denominator of which is the amount of redemption proceeds.

The tax exemption for accrued interest is subject to a phase-out when the taxpayer's modified adjusted gross income exceeds a specified level. The amount of accrued interest otherwise excludable is also reduced (but not below zero) with regard to the phase-out rules.

The exclusion is available only for an individual who has purchased the redeemed bonds after attaining age 24, and is the sole owner of those bonds or the joint owner with his or her spouse. The exclusion is not available to an owner who was not the original purchaser of the bonds from the United States unless the original purchaser was the owner's spouse.

Qualified higher education expenses include tuition and required fees net of scholarships, fellowships, employer-provided educational assistance, and other tuition reduction amounts, but do not include expenses for any course or other education involving sports, games or hobbies other than as a part of a degree program.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new rules apply to tax years beginning after 1989. The bonds with respect to which interest is excludable are Series EE bonds issued after 1989 at a discount to the purchaser-owner.

STATE REVENUE IMPACT

Not applicable to California. Interest earned on U.S. savings bonds is excludable for state tax purposes.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: MODIFIES EXEMPTION FOR STUDENT DEPENDENTS

Act Section 6010

BACKGROUND

A taxpayer generally may not claim a dependency exemption for a dependent whose gross income for the year exceeds the exemption amount ($1,950 in 1988). However, this gross income test does not apply if the dependent is (1) a child of the taxpayer and (2) a full-time student at a qualified educational institution, regardless of the student's age. "Student" is defined as an individual who during each of five calendar months during the calendar year in which the taxpayer's taxable year begins is a full-time student at, or is pursuing a full-time course of on-farm training under the supervision of an accredited agent of a qualifying educational institution. The student may not claim a personal exemption on his or her own return if his or her parents (or another taxpayer) are entitled to claim him or her as a dependent on their return.

CURRENT CALIFORNIA LAW (Sec. 17054(d)(1))

California allows an exemption credit for each dependent for whom an exemption is allowable under Section 151(c) of the Internal Revenue Code.

NEW FEDERAL LAW (Sec. 151(c)(1)(B))

This Act amends the code by denying a dependency exemption for a dependent who is a student who has attained the age of 24 years before the close of the calendar year, unless the student's gross income for the year is less than the exemption amount. If the parent cannot claim the exemption under this rule, the child may claim a personal exemption on his or her own return.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The age and income limitations on the student dependency exemption deduction apply to taxable years beginning after December 31, 1988.

STATE REVENUE IMPACT

Based on federal estimates and allowing for the use of exemption credits rather than deductions at the state level, revenue gains for California would be in the $1 million range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE A: Provisions Relating to Individuals

ACTION: PRINCIPAL RESIDENCE GAIN EXCLUSIONS MODIFIED

Act Section 6011

BACKGROUND

The once-in-a-lifetime exclusion of gain from sale of personal residence was first enacted into federal law in 1963. The provision was substantially modified in 1978 and the age requirement was lowered from 65 to 55.

California law generally followed federal law from 1964 through 1977. For the years 1978 through 1981 California had no age limitation, whereas the Federal exclusion applied only to individuals over age 55. Because of that difference, a taxpayer who was under 55 may have used the California exclusion during the period 1979-1981, but would have been prevented by the age limitation from using the Federal exclusion at that time. In such a case, the taxpayer would be eligible for the Federal exclusion after reaching age 55, but could not use the once-in-a-lifetime California exclusion again. This would apply to taxpayers who were not 55 at some time during the 1978 through 1981 period.

CURRENT CALIFORNIA LAW (Sec. 17131 and 17152)

Both California and Federal laws provide a $125,000 once-in-a-lifetime elective exclusion for gain on sale or exchange of a principal residence ($62,500 for a married person filing separately). To qualify, the taxpayer must be 55 years of age or older and have owned the home for 5 years and occupied it for three or more of the five years proceeding the sale.

NEW FEDERAL LAW (IRC Sec. 121(d))

The Act amends federal law to provide that a taxpayer is treated as meeting the required use rule (three out of 5 years proceeding the sale of the residence) if during the five year period the taxpayer becomes physically or mentally incapable of self care and (1) owns and uses the residence for at least one year and (2) during any time within such five-year period owns the property and resides in a state-licensed facility (including a nursing home) that cares for individuals who have become mentally and physically incapable of self care.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to sales of residences occurring after September 30, 1988.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, revenue losses under the Personal Income Tax Law would be in the $1 million range for 1989-90 and the $800,000 range for 1990-91.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agriculture

ACTION: REPEALS UNIFORM CAPITALIZATION RULES FOR FREELANCE AUTHORS, PHOTOGRAPHERS, AND ARTISTS

Act Section 6026(a)

BACKGROUND

The federal Tax Reform Act of 1986 (P.L. 99-514) enacted the uniform capitalization rules, which generally apply to the production of all tangible personal property and to the purchase and holding of property for resale. For the purpose of these rules, tangible personal property includes a film, sound recording, video tape, book, or similar property. Regulations implementing these provisions require capitalization of all direct costs and an allocable portion of indirect costs (i.e., general, administrative and overhead costs).

The IRS has provided an elective simplified method for deducting (50% in the year in which incurred and 25% in each of the two succeeding years) business expenses of authors, photographers, artists, and other similarly situated persons who incur expenses in producing creative properties.

The Revenue Act of 1987, included in the federal Omnibus Budget Reconciliation Act (P.L. 100-203), included (formerly excluded) contributions to a pension or annuity plan, to the extent those contributions represent past service costs, as a cost to be capitalized.

CURRENT CALIFORNIA LAW (Sec. 17201, 17551 and 24422.3)

California conformed to the uniform capitalization rules enacted by the Tax Reform Act of 1986 (AB 53, Stats. of 1987, Ch. 1138, and SB 572, Stats. of 1987, Ch. 1139), but has not conformed to the rules requiring the capitalization of that portion of expenses that represent past service pension costs, added by the Revenue Act of 1987.

NEW FEDERAL LAW (Sec. 263A(h) and (i))

This Act section amends the code to provide that the uniform capitalization rules do not apply to any otherwise deductible expense that is paid or incurred by an individual engaged in the business of being a writer, photographer, or artist. This exemption applies only to an individual whose personal efforts create or may reasonably be expected to create a literary manuscript, musical composition, dance score, photograph, photographic negative or transparency, picture, painting, sculpture, statue, etching, drawing, cartoon, graphic design, or original print edition. This exemption does not apply to any expense that is (1) paid or incurred by an employee or (2) related to printing, photographic plates, motion picture films, video tapes, or similar items.

In determining whether an expense is paid or incurred in the business of being an artist, the originality and uniqueness of the item created (or to be created) and the predominance of aesthetic value over utilitarian value of the item are taken into account. Thus, any expense paid or incurred in producing jewelry, silverware, pottery, furniture, and other similar household items generally is not considered as being paid or incurred in the business of being an artist.

Expenses paid or incurred by a personal service corporation that directly relate to the activities of a qualified employee-owner qualify for the exemption to the extent that the expenses would qualify if paid or incurred directly by the employee-owner. A qualified employee-owner is defined as any writer, photographer, or artist who is an employee-owner of the personal service corporation and who (alone or in conjunction with members of the employee-owner's family) owns substantially (95% or more) of the value of the corporation's stock.

EFFECTIVE DATE OF FEDERAL PROVISIONS

New subsection (h), relating to freelance authors, photographers and artists, added by Act Sec. 6026(a), is effective as if included in the provisions of the Tax Reform Act of 1986 (costs incurred after December 31, 1986). Eligible taxpayers who elected the simplified method for deducting business expenses in any tax year ending before November 10, 1988, the date of enactment of TAMRA, may either (1) apply the provisions of this Act for each year that the election was in effect by filing an amended return for such year or (2) apply the provisions of this Act for the first tax year ending after November 10, 1988, the date of enactment of TAMRA.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, revenue losses under the Personal Income Tax Law are estimated to be in the $1.5 million range for 1989-90 and in the $100,000 range for 1990-91.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agriculture

ACTION: REPEALS UNIFORM CAPITALIZATION RULES FOR CERTAIN PRODUCERS OF ANIMALS

Act Section 6026(b)

BACKGROUND

The federal Tax Reform Act of 1986 (P.L. 99-514) enacted the uniform capitalization rules which generally apply to the production of all tangible personal property and to the purchase and holding of property for resale. Regulations implementing these provisions require capitalization of all direct costs and an allocable portion of indirect costs (i.e., general, administrative and overhead costs).

Special rules apply to costs incurred in the trade or business of farming. Generally, the uniform capitalization rules apply only to costs (including interest) incurred in producing crops and livestock (other than animals held for slaughter) that have a preproductive period exceeding two years. Farm corporations, farm partnerships with corporate partners, and tax shelters that are required to use the accrual method of accounting must capitalize preproductive costs without regard to whether the preproductive period exceeds two years.

The Revenue Act of 1987, included in the federal Omnibus Budget Reconciliation Act (P.L. 100-203), included (formerly excluded) contributions to a pension or annuity plan, to the extent those contributions represent past service costs, as a cost to be capitalized.

CURRENT CALIFORNIA LAW (Sec. 17201, 17551 and 24422.3)

California conformed to the uniform capitalization rules enacted by the Tax Reform Act of 1986 (AB 53, Stats. of 1987, Ch. 1138, and SB 572, Stats. of 1987, Ch. 1139), but has not conformed to the rules requiring the capitalization of that portion of expenses that represent past service pension costs, added by the Revenue Act of 1987.

NEW FEDERAL LAW (Sec. 263A(d)(1)(A))

This Act section amends the code by exempting from the application of the uniform capitalization rules otherwise deductible expenses that are incurred by a taxpayer in connection with the production of animals in any farming business.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendment is applicable to costs incurred after December 31, 1988.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, revenue losses under the Personal Income Tax Law are estimated to be in the $9 million range for 1989-90 and in the $7 million range for 1990-91. These estimates assume an enactment date after June 30, 1989.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agricultural

ACTION: PROVIDES FOR ELECTION BY PRODUCERS OF PISTACHIO NUTS TO DEDUCT PREPRODUCTIVE COSTS CURRENTLY

Act Section 6026(c)

BACKGROUND

The federal Tax Reform Act of 1986 (P.L. 99-514) enacted the uniform capitalization rules which generally apply to the production of all tangible personal property and to the purchase and holding of property for resale. Regulations implementing these provisions require capitalization of all direct costs and an allocable portion of indirect costs (i.e., general, administrative and overhead costs).

Certain farmers, including ranchers, producers of nursery stock and ornamental trees, and the traditional growers of agricultural crops, may irrevocably elect to disregard the preproductive period capitalization rules and to claim otherwise allowable current expense deductions for preproductive period costs of plants and animals. The election must be made for the first tax year beginning after 1986 in which the taxpayer is a farmer. No such election can be made for costs pertaining to pistachio trees.

Farming corporations, partnerships with corporate partners, and tax shelters may not make such election. Costs attributable to the planting, cultivation, maintenance or development of a citrus or almond grove and incurred before the end of the fourth year after the year in which the trees were planted are not eligible for such elective treatment.

The Revenue Act of 1987, included in the federal Omnibus Budget Reconciliation Act (P.L. 100-203), included (formerly excluded) contributions to a pension or annuity plan, to the extent those contributions represent past service costs, as a cost to be capitalized.

CURRENT CALIFORNIA LAW (Sec. 17201, 17551 and 24422.3)

California conformed to the uniform capitalization rules enacted by the Tax Reform Act of 1986 (AB 53, Stats. of 1987, Ch. 1138, and SB 572, Stats. of 1987, Ch. 1139), but has not conformed to the rules requiring the capitalization of that portion of expenses that represent past service pension costs, added by the Revenue Act of 1987.

NEW FEDERAL LAW (Sec. 263A(d)(3)(B))

This Act section amends the code by providing that taxpayers who are not required to use an accrual method of accounting may elect to currently deduct costs incurred in the planting, cultivation, maintenance, or development of pistachio trees. If the election is made, gain from the disposition of pistachio nuts is taxed as ordinary income to the extent of prior deductions that would have been capitalized but for the election. Additionally, all farm assets placed in service in any tax year that the election is in effect are subject to the alternative depreciation system (straight line over the class life).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendment relating to pistachio trees is effective as if included in the provisions of the Tax Reform Act of 1986 (costs incurred after December 31, 1986).

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, revenue losses under the Personal Income Tax Law would be in the $1 million range for 1989-90 and in the $300,000 range for 1990-91. These estimates allow for the fact that over 95% of the pistachio nut production occurs in California.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agriculture

ACTION: CLASS LIFE OF SINGLE PURPOSE AGRICULTURAL OR HORTICULTURAL STRUCTURES MODIFIED

Act Section 6027

BACKGROUND

For federal purposes the Modified Accelerated Cost Recovery System (MACRS) is mandatory for most tangible personal property placed in service after December 31, 1986 unless transitional rules apply. This system, generally, replaced the Accelerated Cost Recovery System and was introduced in the Federal 1986 Tax Reform Act (TRA).

CURRENT CALIFORNIA LAW (Sec. 17250)

California has adopted federal depreciation provisions (MACRS) including the asset expense allowance under the Personal Income Tax Law applicable to assets placed in service after 1986. Assets placed in service prior to 1987 continue to be depreciated under pre-1987 California law. The Bank and Corporation Tax Law has not been conformed to federal law.

The MACRS provisions assign property to specific class lives and each of these class lives has a statutory method of calculating the depreciation over the span of these lives. Some of these methods are; double declining balance; 150% declining balance; sum-of-the-years-digits and straight line.

Single-purpose agricultural and horticultural structures are assigned a 7-year recovery period based on the asset depreciation range system. (This system is used to place all property in a class according to their estimated life expectancy.)

NEW FEDERAL LAW (Sec. 168 (e)(3)(D))

Single-purpose agricultural and horticultural structures are assigned a recovery period of 10 years for MACRS purposes for property placed in service after 1988. A 15-year recovery period applies to single purpose agricultural or horticultural structures for purposes of MACRS straight-line method.

The Secretary of the Treasury is responsible for assigning property to specific class lives, however, pre-1988 statutes prohibit the Secretary from assigning a longer recovery period to such structures that are placed in service before January 1, 1992. Committee reports indicate that the House Ways and Means Committee believes that these structures should be assigned longer recovery periods than under present-law in order to reflect more accurately the economic lifespan of these structures. The committee believes that this change will discourage passive tax-motivated investments in certain farming businesses.

EFFECTIVE DATE OF THIS PROVISION

The provision generally applies to structures placed in service on or after January 1, 1989. An exception is provided for any property placed in service before January 1, 1990 if such property (1) is constructed, reconstructed, or acquired by the taxpayer pursuant to a written contract that was binding on July 14, 1988, or (2) is constructed or reconstructed by the taxpayer and such construction or reconstruction began by July 14, 1988.

STATE REVENUE IMPACT

California has not adopted MACRS depreciation under the Bank and Corporation Tax Law. Revenue gains under the Personal Income Tax Law would be minor, probably less than $200,000 annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: *Provisions Relating to Accounting and Agriculture*

ACTION: CLASS LIFE OF PROPERTY USED IN FARMING BUSINESS MODIFIED

Act Section 6028

BACKGROUND

For federal purposes the Modified Accelerated Cost Recovery System (MACRS) is mandatory for most tangible personal property placed in service after December 31, 1986 unless transitional rules apply. This system generally, replaced the Accelerated Cost Recovery System and was introduced in the Federal 1986 Tax Reform Act (TRA).

CURRENT CALIFORNIA LAW (Sec. 17250)

California has adopted federal depreciation provisions (MACRS) including the asset expense allowance under the Personal Income Tax Law applicable to assets placed in service after 1986. Assets placed in service prior to 1987 continue to be depreciated under pre-1987 California law. The Bank and Corporation Tax Law has not been conformed to federal law.

The MACRS provisions assign property to specific class lives and each of these class lives has a statutory method of calculating the depreciation over the span of these lives. Some of these methods are; double declining balance; 150% declining balance; sum-of-the-years-digits and straight line.

Generally, farm property is assigned a 7 year class life and requires the use of the double declining balance method for determining the amount of depreciation.

NEW FEDERAL LAW (168(b)(2))

The Act requires that farm property be depreciated using the 150 percent declining balance method. Taxpayers who remain subject to the rules requiring the capitalization of preproductive expenses and who elect to deduct preproductive period expenses will continue to use the alternative depreciation system which uses longer recovery periods and the straight line method of depreciation.

Committee reports indicate that the committee believed that this change is necessary in order to discourage passive tax-motivated investments in certain farming businesses.

EFFECTIVE DATE OF THIS PROVISION

The provision generally applies to property placed in service on or after January 1, 1989. An exception is provided for any property placed in service before July 1, 1989 if such property (1) is constructed, reconstructed, or acquired by the taxpayer pursuant to a written contract that was binding on July 14, 1988, or (2) is constructed or reconstructed by the taxpayer and such construction or reconstruction began by July 14, 1988.

STATE REVENUE IMPACT

California has not adopted MACRS depreciation under the Bank and Corporation Tax Law. Revenue gains under the Personal Income Tax Law from conforming to this change are estimated to be in the $2 million range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agriculture

ACTION: CLARIFY DEPRECIATION METHOD OF CERTAIN TREES

Act Section 6029

BACKGROUND

For federal purposes the Modified Accelerated Cost Recovery System (MACRS) is mandatory for most tangible personal property placed in service after December 31, 1986 unless transitional rules apply. This system generally, replaced the Accelerated Cost Recovery System and was introduced in the Federal 1986 Tax Reform Act (TRA).

For prior federal law (pre-1988) it is unclear whether trees and vines are classified as land improvements with a midpoint life of 20 years or have no class life. Assets assigned to a 20 year class life use the 150% declining balance method switching to straight line at a time to maximize the depreciation deduction.

CURRENT CALIFORNIA LAW (Sec. 17250)

California has generally adopted federal depreciation provisions (MACRS) including the asset expense allowance under the Personal Income Tax Law applicable to assets placed in service after 1986. Assets placed in service prior to 1987 continue to be depreciated under pre-1987 California law. The Bank and Corporation Tax Law has not been conformed to federal law.

The MACRS provisions assign property to specific class lives and each of these class lives has a statutory method of calculating the depreciation over the span of these lives. Some of these methods are; double declining balance; 150% declining balance; sum-of-the-years-digits and straight line.

NEW FEDERAL LAW (Sec. 168(e)(3)(D)(ii))

The Act provides that the class life for trees or vines bearing fruit or nuts will be 20 years and that the depreciation deduction is to be calculated using the straight line method over a 10 year recovery period.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for property placed in service on or after January 1, 1989.

STATE REVENUE IMPACT

California has not adopted MACRS depreciation under the Bank and Corporation Tax Law. Revenue losses under the Personal Income Tax Law from conforming to this change are estimated to be in the $200,000 range for 1989-90 and the $400,000 range for 1990-91.

TITLE IV: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agriculture

ACTION: ONE-YEAR DEFERRAL OF PROCEEDS FROM LIVESTOCK SOLD ON ACCOUNT OF DROUGHT

Act Section 6030

BACKGROUND

Generally, insurance proceeds which indemnify a business from lost sales are in the nature of a substitute for those sales which, if they had taken place, would have been included in income. Thus, the insurance proceeds for those taxpayers who utilize the cash method of accounting would normally be included in the taxable or income year in which they were received. Both state and federal law contain a special provision which allows a cash basis taxpayer who receives insurance proceeds as a result of the sale or exchange of livestock on account of drought to elect to include the income in the year following the loss if it can be shown that the income from the livestock would have been reported in that year.

CURRENT CALIFORNIA LAW (Sec. 17551 and 24661)

In determining accounting periods and methods of accounting California generally conforms to the federal provisions.

NEW FEDERAL LAW (Sec. 451(e))

For taxable years after 1987, the Act broadens the term livestock, for drought sales or exchange purpose to include cattle, horses and other livestock held for draft, dairy or sporting purposes.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to sales or exchanges occurring on or after January 1, 1988.

STATE REVENUE IMPACT

The impact on state revenue collections from this provisions would be insignificant with regard to drought conditions existing in California. It is possible for some California taxpayers to experience losses attributed to drought conditions in other states. Federal estimates for the nation are rather minor. Comparable state revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: *Provisions Relating to Accounting and Agriculture*

ACTION: CERTAIN REPLEDGES PERMITTED

Act Section 6031

BACKGROUND

The Revenue Act of 1987 provided special rules that apply to any nondealer real property installment obligation that arises out of the sale of real property used in a taxpayer's trade or business or in the production of rental income where the selling price of the property exceeds $150,000. Under these rules, if any indebtedness is secured directly by a nondealer real property installment obligation, the net proceeds of the secured indebtedness are treated as payment on such obligation. This rule applies to nondealer installment obligations that are pledged as security for a loan after December 17, 1987.

For example: A taxpayer sells his apartment building for $200,000 in a nondealer installment obligation transaction. The taxpayer agrees to accept $100,000 cash and takes a note from the purchaser for $100,000. Assume that the gain realized to the taxpayer (after determining the basis and other cost calculations) is $100,000. The taxpayer can then elect to include in gross income the $100,000 gain in the year of the sale or elect to defer the gain through the installment obligation rules. (If the taxpayer elects to defer the gain, then a portion of the amount of the payments received from the note are included in the taxpayer's income.) Assuming the taxpayer elects to defer the gain, the gross profit percentage in the example would be 50%. Therefore 50% of the $100,000 that was received at the time of the sale is included as gain in the taxpayer's income in the year of the sale. The remaining $100,000 in payments to be received in subsequent years would be included in the taxpayer's income after applying the gross profit percentage to the payment received each year.

If the taxpayer obtains a loan and uses the note from the installment obligation as collateral, then the net proceeds would be considered a payment on the installment obligation. The 50% gross profit percentage factor would then apply to the net proceeds of the loan transaction (up to the amount of the pledged note). This would accelerate the inclusion of the gain into the taxpayer's income.

CURRENT CALIFORNIA LAW (Sec. 17551, 17560 and 24667)

California law generally conforms to the 1986 federal provisions but did not conform to the rules contained in the federal Revenue Act of 1987.

Noncorporate taxpayers have a choice to either elect the installment obligation rules or the proportionate disallowance rules. The reason for allowing a noncorporate taxpayer the installment method for tax purposes is that the seller might be unable to pay tax currently since no cash would be available until installment payments are received. Noncorporate taxpayers who elect the installment obligation rules and who secure later indebtedness with the note which resulted from the installment obligation are not required under California law to include the net proceeds of the loan as a payment on the obligation, and therefore do not include any gain in income upon the pledge.

Corporate taxpayers must use the proportionate disallowance rules. This is because the ability to defer taxation using the installment method is perceived as being inappropriate for gains realized by dealers on ordinary income assets, and also as to gains realized on certain business or rental property to the extent that the taxpayer has been able to receive cash from borrowing on its installment obligation.

<u>NEW FEDERAL LAW</u> (Act Sec. 6031)

This Act section (an uncodified provision) provides that the special rule that treats proceeds of an indebtedness as payment on a nondealer real property installment obligation does not apply to a pledge of the obligation after December 17, 1987 if the indebtedness (loan) is incurred to refinance indebtedness that was:

1. outstanding on December 17, 1987 and

2. secured by the nondealer real property installment obligations on such date and at all times thereafter until the refinancing occurred.

This exception does not apply to the extent that the principal amount of the indebtedness resulting from the refinancing exceeds the amount of the refinanced indebtedness immediately before the refinancing. If the refinancing of the indebtedness is attributable to the creditor's calling of indebtedness (i.e., a balloon payment or payment on demand clause) it is treated as a continuation of the indebtedness if the refinancing is provided by a person other that the original creditor or a person related to the original creditor.

<u>EFFECTIVE DATE OF FEDERAL PROVISIONS</u>

This provision applies to pledges after December 17, 1987.

<u>STATE REVENUE IMPACT</u>

California has not conformed to the 1987 Federal Act installment sale provisions which were estimated to produce state revenue <u>gains</u> of approximately $200 million over the first three years. Should California conform to the 1987 provisions, the treatment of certain pledged installment obligations in the 1988 Act would result in a minor revenue <u>loss</u> for the first year followed by negligible revenue effects in subsequent years.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provisions Relating to Accounting and Agriculture

ACTION: REQUIRES REGULATIONS THAT PROVIDE TO WHAT EXTENT STOCK OWNED BY NONGRANTOR TRUSTS IS TO BE TREATED AS INDIRECTLY OWNED BY THE BENEFICIARIES OF SUCH TRUSTS

Act Section 6032

BACKGROUND

Generally, for tax years beginning after 1986, use of the cash method of accounting is limited to corporations and partnerships with annual gross receipts of $5 million or less, S corporations, sole proprietorships and partnerships that have no C corporation partners. Qualified personal service corporations may also use the cash method if they are substantially involved in performing services in the fields of health, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and if all their stock is substantially owned (95 percent in value) by employees performing services in these fields, their estates, or anyone acquiring an ownership interest by reason of that person's death within the past 24 months.

CURRENT CALIFORNIA LAW (Sec. 17562 and 24654)

California law is conformed to federal law.

NEW FEDERAL LAW (Sec.448(d)(2))

Federal law is amended to take into account (in determining whether the ownership test is satisfied) indirect holdings through a trust to the extent provided in regulations to be prescribed by the Treasury Department.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendment shall apply to tax years beginning after December 31, 1986.

STATE REVENUE IMPACT

Based on the low level of revenue losses estimated for the nation by the Joint Committee on Taxation, comparable state revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE B: Provision Relating to Accounting and Agriculture

ACTION: ALLOWS A TAXPAYER TO DEFER CERTAIN PROCEEDS RELATING TO CROP INSURANCE TO THE FOLLOWING YEAR

Act Section 6033

BACKGROUND

A cash method taxpayer who receives insurance proceeds as a result of destruction or damage to crops may elect to include the proceeds in income for the taxable year following the year in which the destruction occurs. A taxpayer may elect to include such proceeds in income in the taxable year following the year of damage as long as the taxpayer would have normally reported the income in the following year.

Payments received under the Agricultural Act of 1949 as a result of:

1. destruction or damage to crops caused by drought, flood, or other natural disaster, or

2. the inability to plant crops because of such natural disaster are treated as insurance proceeds and the taxpayer is allowed to elect to include the payment in the following year.

CURRENT CALIFORNIA LAW (Sec. 17551)

California is in conformity with federal law.

NEW FEDERAL LAW (Sec. 451)

The Act amends the section to treat any payments received under Title II of the Disaster Assistance Act of 1988 as insurance proceeds and thus the taxpayer is allowed to elect to defer the reporting of the payment until the following year.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to payments received before, on, or after November 10, 1988.

STATE REVENUE IMPACT

According to the State Food and Agriculture Department, payments received by California producers under Title II would make up a very small percentage of the total for the nation (2-3 percent). Federal estimates for the nation are rather minor. Comparable state revenue losses would be minor, possibly in the $500,000 range for 1989-90 and decreasing to negligible amounts thereafter.

TITLE IV: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee benefits

ACTION: EXEMPTION FROM EMPLOYEE BENEFIT NONDISCRIMINATION RULES FOR CHURCH PLANS

Act Section 6051(a)

BACKGROUND

The federal Tax Reform Act of 1986 established special rules with regard to amounts that must be included in the income of highly compensated employees. In addition, that Act:

1. Established new eligibility and benefit nondiscrimination rules applicable to group-term life insurance plans and accident or health plans (insured or self-insured);

2. Allowed employers to elect to apply those rules to certain other types of plans;

3. Established a special benefits rule for dependent care assistance programs;

4. Established uniform definitions; and,

5. Permitted satisfaction of the nondiscrimination rules for group-term life insurance plans and accident or health plans on a line of business or operating unit basis.

CURRENT CALIFORNIA LAW (Sec. 17081)

California conformed for post-1986 tax years to the extensive changes in the federal law applicable to tax years beginning after 1986 and to technical changes made by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec.89)

The act provides that the nondiscrimination requirements of Internal Revenue Code Section 89 do not apply to statutory employee benefit plans maintained by a church for church employees.

The term "church" is defined to include:

1. A convention or association of churches,

2. An elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches; and,

3. Any church-controlled tax-exempt organization that does not receive substantial support from governmental sources or sales of goods or services.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective as if it had been included in the Tax Reform Act of 1986 and generally will apply to years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Based on very minor revenue losses estimated for the nation, state revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: *Pensions and Employee Benefits*

ACTION: EXEMPTION FROM EMPLOYEE BENEFIT NONDISCRIMINATION RULES FOR CAFETERIA PLANS.

Act Section 6051(b)

BACKGROUND

This change was made to clarify the original Congressional intent that the nondiscrimination rules (with regard to highly compensated employees) be focused on available nonelective contributions.

CURRENT CALIFORNIA LAW (Sec. 17131)

California conforms for post-1986 tax years to extensive changes in the federal law relating to nondiscrimination rules applicable to tax years beginning after 1986 and to technical changes made by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec. 125(c)(2)(C))

The Act provides that post-retirement life insurance funded under a cafeteria plan must be tested for discrimination when it is funded based on the amount of life insurance that could at that time be purchased with the cafeteria plan elective contributions.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective as if it were included in the Tax Reform Act of 1986 and generally will apply to years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Based on very minor revenue losses estimated for the nation, state revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: MODIFICATIONS OF NONDISCRIMINATION RULES APPLICABLE TO CERTAIN ANNUITY CONTRACTS

Act Section 6052

BACKGROUND

The Tax Reform Act of 1986 provided that the nondiscrimination rules apply to contributions to tax-sheltered annuity programs. With respect to contributions pursuant to a salary reduction agreement, the nondiscrimination rules generally require that the ability to make salary reduction contributions be available to all employees.

With respect to other contributions, the nondiscrimination rules are the same nondiscrimination rules applicable to qualified pension plans.

CURRENT CALIFORNIA LAW (Sec. 17501 and 17506)

California conformed to the extensive changes in federal law made by the Tax Reform Act of 1986 which first became effective taxable years beginning on or after January 1, 1989.

NEW FEDERAL LAW (Sec. 403(b))

The Act modifies the nondiscrimination rules applicable to contributions to tax sheltered annuity programs not made pursuant to a salary reduction agreement as follows:

1. Student employees who are not taken into account for employment tax purposes may be disregarded;

2. Employees who normally work less than 20 hours per week may be disregarded; and

3. For plan years beginning before January 1, 1992, the nondiscrimination rules may (under a noncode provision) be applied by testing a statistically valid sample of employees.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective as if included in Section 1120(b) of the Tax Reform Act of 1986 and is applicable to taxable years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

The Joint Committe on Taxation estimates revenue losses for the nation of only $500,000 annually. State revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: REQUIRED DISTRIBUTION BEGINNING DATE FOR GOVERNMENTAL AND CHURCH PLANS

Act Section 6053

BACKGROUND

The Tax Reform Act of 1986 (effective for taxable years beginning after December 31, 1988) required that distributions under all qualified plans, IRAs, tax-sheltered custodial accounts and annuities, and eligible deferred compensation plans of state and local governments and tax-exempt employers must commence no later than April 1 of the calendar year following the calendar year in which the participant or owner attains age 70.5, without regard to the actual date of separation from service.

CURRENT CALIFORNIA LAW (Sec. 17501)

California conformed to the changes made by federal law under the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec. 401)

The Act provides that, in the case of governmental plans or plans maintained by a church, including qualified church-controlled organizations, the required beginning date is the later of:

1. The required beginning date under the normal rule; or

2. April 1 of the calendar year following the calendar year in which the employee retires.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective as if included in the Tax Reform Act of 1986, applicable to taxable years beginning after December 31, 1988.

STATE REVENUE IMPACT

The Joint Committe on Taxation estimates revenue <u>losses</u> of only $500,000 annually for the nation. State revenue <u>losses</u> would be negligible annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: SECTION 415 LIMITATION FOR STATE AND LOCAL PLANS

Act Section 6054

BACKGROUND

Prior to this Act, federal law provided overall limits on contributions and benefits under qualified plans. The limits applied to all such contributions and benefits provided by any private or public employer.

CURRENT CALIFORNIA LAW (Sec. 17501)

California is conformed to federal law, including changes made to Section 415 made by the federal 1986 Tax Reform Act.

NEW FEDERAL LAW (Sec. 415)

Under this Act, in the case of a plan maintained for its employees by any state or political subdivision, the limitation on benefits under a defined benefit pension plan will not be less than the accrued benefits of a qualified participant under the plan (determined without regard to any amendment of the plan made after October 14, 1987). A qualified participant is defined as a participant who first became a participant in the plan maintained by the employer before January 1, 1990.

In order to qualify for this special limitation, the employer maintaining the plan must elect to satisfy the general requirements of IRC Section 415, without regard to the special rules for public plans (other than the special rules for police and firefighters).

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is generally effective for years beginning after 1982. The employer's election is required to be made before the close of the first plan year beginning after December 31, 1989.

STATE REVENUE IMPACT

The Joint Committe on Taxation estimates revenue losses of only $500,000 annually for the nation. State revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: MINIMUM PARTICIPATION STANDARDS

Act Section 6055

BACKGROUND

The Tax Reform Act of 1986 provided that a plan is not a qualified plan unless it benefits the lesser of:

1. 50 employees; or

2. 40 percent of all of an employer's nonexcludable employees.

CURRENT CALIFORNIA LAW (Sec. 17501)

California law is conformed to the changes to federal law made by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec. 401)

The Act provides that the minimum participation rule (plans that must benefit at least 50 employees or 40% of all employees of the employer, whichever is lesser) can be applied to employees of a governmental employer that provides police, firefighting or emergency medical services separately from other employees.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The election that governmental employers can make to utilize this provision is effective generally for plan years beginning after 1988 but a special rule for collective bargaining agreements is provided.

STATE REVENUE IMPACT

The Joint Committe on Taxation estimates revenue losses of only $500,000 annually for the nation. State revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: PROHIBITION ON COLLECTIBLES NOT TO INCLUDE STATE COINS

Act Section 6057

BACKGROUND

Prior to the passage of the Tax Reform Act of 1986, federal law prohibited the investment of individual retirement plans in collectibles because it was considered too difficult to verify the existence of collectibles.

The Tax Reform Act of 1986 created a limited exception to this rule and permitted individual retirement accounts to invest in legal tender gold and silver coins minted by the United States. Such coins were required to be held by a disinterested third party, and could not be held by the individual investor.

This exception applied to acquisitions made after December 31, 1986.

CURRENT CALIFORNIA LAW (Sec. 17501)

California conformed to the changes made to federal law by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec. 408(m))

The Act provides that coins issued under the laws of any state are not treated as collectibles for purposes of the IRA prohibition on investments in collectibles, as long as the coins are held by a person independent of the IRA owner.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective with respect to state coins acquired by an IRA after November 10, 1988.

STATE REVENUE IMPACT

Negligible impact.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: APPLICATION OF FUNDING RULES TO MULTIPLE EMPLOYER PLANS

Act Section 6058

BACKGROUND

Under current federal law, the minimum funding requirement with respect to a multiple employer plan and the maximum permissible deduction for a contribution to a multiple employer plan is calculated at the plan level and not at the level of the contributing employer.

CURRENT CALIFORNIA LAW (Sec. 17509)

California conformed to the changes made to federal law by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec. 413)

Under the Act, in the case of a plan established after December 31, 1988, each employer participating in a multiple employer pension plan is treated as maintaining a separate plan for purposes of the minimum funding standard unless the plan uses a method for determining required contributions that ensures that any employer contributes an amount at least equal to the amount that would be required if the employer maintained a separate plan.

In addition, the assets and liabilities of each plan treated as a separate plan are the assets and liabilities that would be allocated to a plan maintained by the employer, if the employer withdrew from the multiple employer plan.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for plans established after 1988. In the case of a multiple employer plan established before 1989, the plan administrator is permitted to elect to have the new rule apply to the plan.

STATE REVENUE IMPACT

Negligible impact.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pension and Employee Benefits

ACTION: APPLICATION OF SECTION 415 LIMITATIONS TO POLICE AND FIREFIGHTERS

Act Section 6059

BACKGROUND

Present law provides overall limits on contributions and benefits under qualified pension, profit-sharing, and stock bonus plans, qualified annuity plans, tax-sheltered annuities, and simplified employee pensions (SEPs). In addition, present law provides a special floor on the annual limit on benefits with respect to certain police and firefighters. In the case of a qualified participant, the present law reduction provided for benefits payable before age 62 does not reduce the dollar limit on annual benefits below $50,000 at any age.

A qualified participant is a participant in a defined benefit pension plan maintained by a State or political subdivision of a State if the period of service taken into account in determining the participant's benefit under the plan includes at least 20 years of the participants service, as specified.

CURRENT CALIFORNIA LAW (Sec. 17501)

California law is conformed to federal law.

NEW FEDERAL LAW (Sec. 415)

The Act provides that the 20 years of service requirement for eligibility for the special rule for police and firefighters is decreased to 15 years.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for plan years beginning after 1986.

STATE REVENUE IMPACT

Negligible impact for state purposes.

TITLE VI: Other Substantive Revenue Provisions

ACTION: MISCELLANEOUS PROVISIONS MODIFYING EXCISE TAXES, INSURANCE COMPANY TAXATION AND TREASURY STUDIES

Act Section 6060, 6069, 6129, 6131 and 6252

BACKGROUND

The federal government imposes numerous excise taxes either as direct taxes or as penalty provisions throughout the Internal Revenue Code. In addition insurance companies are subject to income taxation at the federal level. The federal code also mandates certain studies to be made by the Secretary Treasury.

CURRENT CALIFORNIA LAW

The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not impose excise taxes nor a tax on the reversion of pension plan assets.

Insurance companies are not subject to the Bank and Corporation Tax Law in California but instead are subject to the gross premiums tax which is administered by the State Controller.

NEW FEDERAL LAW (Sec. 952, 964, 4978A and 4980)

TAMRA increases the excise tax imposed on employers upon the reversion to the employer of pension plan assets from ten to fifteen percent, modifies the insurance company taxation rules dealing with insurance branches of controlled foreign corporations (CFCs) and modifies previously required studies by cancelling two (one on the payment in kind program (PIK) and one on foreign oil and gas tax credit) and modifies due dates of reports on Possessions Corporations and Foreign Sales Corporations.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The increase in the employer reversion tax applies to reversions after October 20, 1988, the insurance company provisions apply to taxable years of foreign corporations beginning after December 31, 1988 while the noncode provision regarding certain studies is effective November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: LOANS TO ACQUIRE EMPLOYER SECURITIES

Act Section 6061

BACKGROUND

Under present law, a bank, an insurance company, a regulated investment company, or a corporation actively engaged in the business of lending money may exclude from gross income 50 percent of the interest received with respect to a securities acquisition loan. A "securities acquisition loan" is generally defined as a loan to a corporation or to an ESOP to the extent that the proceeds are used to acquire employer securities.

CURRENT CALIFORNIA LAW (Sec. 24306)

California law is conformed to the federal provisions for taxable and income years beginning or or after January 1, 1990 and before January 1, 1995.

NEW FEDERAL LAW (Sec. 133 and Act Sec. 6061)

This Act, in a noncode provision, modifies another provision of this Act (Sec. 1011B) by providing that, in the case of the refinancing of a securities acquisition loan that was made before October 22, 1986, the partial interest exclusion is available for the greater of either:

1. The term of the original securities acquisition loan; or,

2. The amortization period used to determine the regular payments under the original securities acquisition loan.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective as if included in the Tax Reform Act of 1986, in general, applicable to loans incurred after October 22, 1986.

STATE REVENUE IMPACT

Negligible revenue losses for state purposes beginning in 1990.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: EFFECTIVE DATE OF SECTION 415 LIMITATIONS FOR COLLECTIVELY BARGAINED AGREEMENTS

Act Section 6062

BACKGROUND

The Tax Reform Act of 1986 (TRA) provided that the limit on the annual benefit provided by a defined benefit pension plan is generally the lesser of:

1. 100 percent of average compensation; or,

2. $90,000.

Prior to the TRA, if payment of retirement benefits began before age 62, then the dollar limit was generally reduced so that it was the actuarial equivalent of an annual benefit of $90,000 beginning at age 62. In no event, however, was the dollar limit applicable to benefits beginning at or after age 55 less than $75,000.

Under the law prior to the enactment of the TRA, if benefits began before age 55, then the dollar limit was actuarially reduced so that it was the greater of the actuarial equivalent of:

1. A $75,000 benefit beginning at age 55, or

2. The applicable dollar limit at age 62.

TRA eliminated the $75,000 floor so that the $90,000 limit is actuarially reduced for a participant retiring before the social security retirement age (currently 65, scheduled to increase to 67).

In the case of a plan maintained pursuant to one or more collective bargaining agreements ratified before March 1, 1986, the TRA provisions do not apply to benefits under such agreements in years beginning before the earlier of:

1. The date on which the last of such collective bargaining agreements terminates; or,

2. January 1, 1989.

CURRENT CALIFORNIA LAW (Sec. 17131)

California conformed to the changes to federal law made by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Act Sec. 6062)

This Act, in a noncode provision, delays the effective date of the TRA provisions in the case of collectively bargained agreements. In the case of a plan established on or before March 1, 1986, pursuant to one or more collective bargaining agreements, the TRA provisions do not apply to contributions or benefits pursuant to such agreements until the first plan year beginning on or after October 1, 1991.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This change is effective as if it were included in the Tax Reform Act of 1986.

STATE REVENUE IMPACT

Negligible revenue losses under state law.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: TREATMENT OF PRE-1989 ELECTIONS FOR DEPENDENT CARE ASSISTANCE UNDER CAFETERIA PLANS

Act Section 6063

BACKGROUND

The Tax Reform Act of 1986 (TRA) limited the employee's exclusion for dependent care assistance programs to $5,000 a year ($2,500 for married taxpayers filing separate returns). Also, TRA required that, for on-site facilities, the amount excluded with respect to any dependent must be based on actual utilization and the value of the services provided.

CURRENT CALIFORNIA LAW (Sec. 17131)

California conformed to the changes made to federal law by the Tax Reform Act of 1986.

NEW FEDERAL LAW (Sec. 125 and Act Sec. 6063)

This Act, in a noncode provision, provides that a plan would not be treated as failing to be a cafeteria plan solely because, under the plan, a participant elected before January 1, 1989 to receive reimbursement under the plan for periods after December 31, 1988, and such assistance is includible in gross income under the provisions of the Family Support Act of 1988.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective November 10, 1988.

STATE REVENUE IMPACT

Negligible impact.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pension and Employer Benefits

ACTION: MODIFICATIONS TO DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS

Act Section 6064

BACKGROUND

Under the 1986 Federal Tax Reform Act the IRS issued a ruling that unfunded vacation, sick leave, compensatory time, severance pay, disability pay and death benefit plans were to be considered deferred compensation plans maintained by state or local governments or by tax-exempt organizations. Considerable controversy arose over that ruling and subsequently IRS Notice 88-68 reversed that position. The notice stated that deferred compensation plans for state or local governments or tax-exempt organizations do not include bona fide vacation, sick leave, compensatory time, severance pay, disability pay and death benefit plans.

CURRENT CALIFORNIA LAW (Sec. 17551)

California conforms to the federal tax treatment of state or local government or tax-exempt organizations deferred compensation plans as defined under the 1986 Tax Reform Act.

NEW FEDERAL LAW (Sec. 457)

The Act codifies the position that vacation, sick leave, compensatory time, severance pay, disability pay, and death benefit plans are not state or local government deferred compensation plans.

The Act also includes a grandfather rule exempting certain nonelective deferred compensation under governmental plans from treatment as deferred compensation plans.

In addition, church plans will not be subject to the limitations imposed under government plans.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to taxable years beginning on or after January 1, 1988. An exception is provided for collectively bargained plans.

STATE REVENUE IMPACT

Conforming to these Section 457 provisions would result in state revenue losses in the $1 million range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: *Pensions and Employee Benefits*

ACTION: AIR TRANSPORTATION OF CARGO AND PASSENGERS TREATED AS *SAME SERVICE FOR PURPOSES OF FRINGE BENEFIT INCLUSIONS.*

Act Section 6066

BACKGROUND

Pre-1988 federal law provides that no-additional-cost service provided by an employer is not included in an employee's gross income. A no-additional-cost service is any service which (1) is offered for sale to customers in the ordinary course of business of the employer in which the employee is performing services; and (2) the employer incurs no substantial additional cost in providing the service. In the case of airlines it is not uncommon for an airline to provide reciprocal agreements to fly with other airline companies for employees. However, the same sort of agreements made by airlines that transport only cargo are not allowed to be excluded from an employee's gross income.

CURRENT CALIFORNIA LAW (Sec. 17131)

California conforms to the 1987 treatment on no-additional-cost services provided to employees by employers. These services, once the tests are met, are not included in a taxpayer's gross income.

Specifically, reciprocal agreements between airlines to transport employees are not included in the employee's gross income as long as the service is in the employer's line of business and the employer incurs no substantial additional cost.

NEW FEDERAL LAW (Sec. 132)

The Act provides that the transportation of cargo by air and the transportation of passengers by air is treated as the same service. Thus, an employee performing services in the air cargo line of business may receive air travel (including air travel under reciprocal agreements with other airlines) as a no-additional-cost service.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for transportation provided on or after January 1, 1988.

STATE REVENUE IMPACT

Based on the low level of revenue losses estimated for the nation, state revenue losses would be very minor annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: MODIFIES RULES FOR DEFINED BENEFIT PLANS IN SPIN-OFFS INVOLVING BRIDGE BANKS

Act Section 6067

BACKGROUND

Act Section 2550(c) added technical changes which are applicable to the treatment of excess assets of defined benefit plans in the case of spin-offs (occurs when a corporation transfers part of its assets to a new corporation in exchange for the stock of the new corporation and the stock is immediately distributed to its shareholders who do not surrender any of their original stock) and similar transactions.

Further consideration was given and additional language subsequently adopted to extend the allocation rules to spin-offs to a bridge bank (a bank established by the Federal Deposit Insurance Corporation (FDIC) to assume the deposits and other liabilities of a closed bank and continue banking operations), and to authorize the bridge bank to cause the plan maintained by the closing bank to spin-off the assets to a defined benefit plan maintained by the bridge bank within 180 days after the closing of the bank.

CURRENT CALIFORNIA LAW (Sec. 17024.5, 17501 and 23051.5)

California law is in conformity with federal law.

NEW FEDERAL LAW (Sec. 414(l)(2)(G))

Under the new provision, federal law is amended to extend the allocation rule for excess assets (assets in excess of the amount required to be allocated to a plan under prior law) of a defined benefit plan to a spin-off to a bridge bank. However, the provision only applies with respect to 50 percent of the excess assets.

In addition, a bridge bank would be authorized to cause the plan maintained by the closing bank to spin off assets to a defined plan maintained by the bridge bank in accordance with the allocation rule within 180 days after the closing of the bank.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions generally apply to transactions occurring after July 26, 1988.

STATE REVENUE IMPACT

National estimates are insignificant, less than $500,000 annually. The state revenue effect would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: INCOME AVERAGING ALLOWED TO LUMP-SUM DISTRIBUTIONS OF ALTERNATIVE PAYEES

Act Section 6068

BACKGROUND

Generally, both California and federal laws tax amounts received under qualified pension or profit-sharing plans to the employee only when actually distributed to the employee.

If an employee's benefits are paid to him/her in one taxable year because of his/her death or termination of employment then the taxable amount is subject to special treatment as a "lump-sum" distribution. The taxable amount is the total distribution minus:

1. employee contributions; and

2. any unrealized appreciation or employer securities included in the distribution.

CURRENT CALIFORNIA LAW (Sec. 17504)

California conformed in 1987 to the imposition of a separate tax on lump-sum distributions applicable to tax years beginning after 1986 and conformed to the manner in which federal law taxed lump-sum distributions. The provisions:

1. Replaced former rules (10 years federal; 5 or 7 years state) with five-year averaging available for a lump-sum distribution received by an individual attaining the age of 59 1/2, and

2. Phased out capital gains treatment for distributions of pre-1974 contributions.

California law also conformed to federal noncode provisions applicable to individuals who attained age 50 by 1986. These provisions allow an election to use 10-year averaging (versus 5 year averaging) but apply the 1986 tax rates. Also, the taxpayer may elect capital gain treatment or treat the capital gain element of the distribution as ordinary income.

NEW FEDERAL LAW (Sec. 402 (e)(4)(O))

This Act clarifies that the lump-sum distribution payment received by an alternate payee who is a spouse or former spouse of an employee is eligible for income averaging if the distribution represents the balance of the credit to the employee and constitutes a lump-sum distribution. In determining whether the distribution consists of the balance of the credit of the alternate payee, only the interest of the alternate payee is considered.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is retroactive and applies to taxable years beginning on or after January 1, 1985.

STATE REVENUE IMPACT

The Joint Committe on Taxation estimates revenue losses of only $7 million annually for the nation. State revenue losses would be minor, in the $250,000 range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions and Employee Benefits

ACTION: DEFINITION OF PART-TIME EMPLOYEE FOR PURPOSES OF BENEFITS PROVIDED UNDER CERTAIN EMPLOYEE BENEFIT PLANS.

Act Section 6070

BACKGROUND

Pre - 1988 federal law for health and certain other employee benefit plans required to them satisfy certain nondiscrimination rules with respect to highly compensated employees. A plan is considered nondiscriminatory if it satisfies three eligibility and benefit tests. Under an alternative test, a plan is considered nondiscriminatory if it benefits at least 80% of the employees who are not highly compensated. In reviewing the employees for the 80% test, employees who work less than 17 1/2 hours a week are not considered.

CURRENT CALIFORNIA LAW (Sec. 17081)

California law currently conforms to federal law which provides criteria that an employee benefit plan must meet in order to qualify for exclusion from the employee's gross income. If a benefit plan does not meet the qualification and eligibility requirements then the value of the plan is included in the employee's gross income subject to income tax.

NEW FEDERAL LAW (Sec. 89(f))

In applying the 80% test to a qualified benefit plan maintained by an employer with less than 10 employees:

1. employees who normally work 35 hours or less per week may be excluded from the test beginning in 1989;

2. employees who normally work 25 hours or less per week may be excluded from the test in 1990.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to tax years beginning on or after January 1, 1989.

STATE REVENUE IMPACT

Based on the low level of revenue losses estimated for tha nation by the Joint Committee on Taxation, state revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE C: Pensions And Employee Benefits

ACTION: ALLOWS RURAL TELEPHONE COOPERATIVES TO ESTABLISH DEFERRED COMPENSATION PLANS ON SAME BASIS AS RURAL ELECTRIC COOPERATIVES

Act Section 6071

BACKGROUND

Federal law allows states and local governments or tax-exempt rural electric cooperatives to establish a deferred compensation plan under which a part of the employee's compensation is not taxed until distributed or made available. The maximum amount that can be deferred annually is the lesser of $7,500 or one-third of the employee's compensation (net of the deferred amount). However, the maximum deferral may be increased to as much as $15,000 a year for the last three years before the tax year in which the participant reaches the normal retirement age under the plan. Also, employer contributions to a tax-deferred annuity are taken into account in figuring whether the employee's deferrals under an eligible deferred compensation plan exceed the limits on such deferrals.

CURRENT CALIFORNIA LAW (Sec. 17501)

California is in conformity with the federal provisions allowing the establishment of deferred compensation plans as described above.

NEW FEDERAL LAW (Sec. 401(k) and 457)

The Act amended federal law by substituting "rural cooperative plan" for "rural electric cooperative plan", thus providing that rural telephone cooperatives are able to establish 401(k) or 457 plans (cash or deferred arrangements) on the same basis as rural electric cooperatives.

A "rural cooperative plan" means any pension plan which is a defined contribution plan and which is established and maintained by a rural cooperative.

A "rural cooperative" is any organization which (1) is exempt from tax or which is a state or local government or political subdivision, agency, or instrumentaltity thereof, and engaged in providing electric service on a mutual or cooperative basis; (2) a nonprofit civic league or local association of employees operated exclusively for the promotion of social welfare, or a nonprofit business league, chamber of commerce, real estate board, board of trade, or professional football league, at least 80% of the members of which are organizations described in (1), above; (3) a cooperative telephone company, if 85% or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses; and (4) an organization which is a national association of organizations described above.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision applies to tax years beginning after November 10, 1988, the date of enactment of TAMRA.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue losses would be in the $200,000 range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE D: Insurance Provisions

ACTION: PROHIBITS, FOR TAXABLE YEARS BEGINNING BEFORE 1987, THE ASSESSMENT OR COLLECTION OF ANY DEFICIENCY ATTRIBUTABLE TO THE TIMING OF A QUALIFIED GROUP SELF-INSURER'S POLICYHOLDER DIVIDEND DEDUCTION

Act Section 6076

BACKGROUND

Under applicable state law or regulation, workers' compensation liabilities may be pooled as self-insured workers' compensation funds. Such funds generally are treated as mutual property and casualty insurance companies for federal income tax purposes, under Subchapter L of Chapter 1 of the Internal Revenue Code. In audits, the IRS has raised the issue of whether the requirements for deductibility of policyholder dividends have been met in cases in which the declared dividend is contingent upon subsequent approval of the amount of the dividend by state regulatory authorities (e.g., the State Workers' Compensation Board). The Tax Reform Act of 1986 (P.L. 99-514) imposed a moratorium with respect to audits and litigation relating to self-insured workers' compensation funds for the period commencing on October 11, 1986, and ending on August 16, 1987.

CURRENT CALIFORNIA LAW

Under the California Constitution insurance companies are subject to a gross premiums tax and are not subject to the Bank and Corporation Tax Law.

NEW FEDERAL LAW (Act Sec. 6076)

Act Section 6076 (a noncode provision) provides that for tax years starting after 1986, deductions for policyholder dividends may not be claimed by a qualified group self-insurer's fund until a state regulatory authority determines the size of dividends that the fund may distribute. For tax years starting before 1987, no deficiency may be assessed against a fund whose deficiency arises simply out of the timing of the policyholder dividends deduction. If an assessment has already been made, it is not to be collected. A "group self-insurer fund" is a group of two or more employers that has been in existence two or more years to pool liabilities that arise under state workers' compensation laws. Funds of this type are generally treated as property and casualty insurance companies.

EFFECTIVE DATE OF FEDERAL PROVISION

The new rules are effective for tax years beginning before January 1, 1987.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE D: Insurance Provisions

ACTION: SPECIAL ESTIMATED TAX PAYMENTS

Act Section 6077

BACKGROUND

Property and casualty insurance companies are required to make estimated payments of taxes due to the federal government. California has never conformed to the federal taxation treatment of insurance companies.

CURRENT CALIFORNIA LAW

Insurance companies, under the California Constitution, are required to pay a gross insurance premiums tax administered by the State Controller's office.

NEW FEDERAL LAW (Sec. 847)

The federal law makes major changes in the manner in which these companies make their estimated tax payments to the federal government.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to taxable years beginning on or after January 1, 1988.

STATE REVENUE IMPACT

Not applicable under Bank and Corporation Tax Law. Estimated tax proposals of this sort would require analysis by the State Controller's Office and the State Board of Equalization.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE D: Insurance Provisions

ACTION: PROVIDES THAT A CHURCH SELF-FUNDED DEATH BENEFIT PLAN FOR ITS EMPLOYEES IS TREATED AS LIFE INSURANCE

Act Section 6078

BACKGROUND

Exclusion for death benefits

Present law generally excludes from a beneficiary's gross income proceeds of death benefits received under a life insurance contract and provides a limited exclusion for other benefits paid by or on behalf of an employer by reason of an employee's death.

Definition of a life insurance contract

A life insurance contract is defined as any contract which is a life insurance contract under the applicable law, but only if the contract meets either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement. If a contract does not satisfy the definition of a life insurance contract, the income on the contract for any taxable year of the policyholder will be treated as ordinary income received or accrued by the policyholder during that year.

Exclusion for cost of group-term life insurance

Under present law, the cost of group-term life insurance purchased by an employer for an employee for a taxable year is included in the employee's gross income to the extent that the cost is greater than the sum of the cost of $50,000 of life insurance plus any contribution made by an employee to the cost of the insurance.

CURRENT CALIFORNIA LAW (Sec. 17020.6, 17131, 23045 and 24305)

California law conforms to federal law.

NEW FEDERAL LAW (Sec. 7702(j))

The Act provides that certain church self-funded death benefit arrangements are included in the term "life insurance contract" even if the arrangements are not life insurance under state law. The death benefit exclusion and the exclusion for the cost of employer-provided group-term life insurance apply to a plan that provides for the death of an individual covered under such a self-funded plan if the plan or arrangement (1) is provided directly by a church for its employees or by a church-controlled organization and (2) satisfies the requirements relating to the definition of a life insurance contract, other than the requirement that the plan be a life insurance contract under state law. Thus, the exclusion from gross income of a beneficiary of death benefits received from a life insurance contract applies to such a church plan or arrangement.

In addition, the cost of such life insurance is includible in gross income, except to the extent that the cost is excludable under Section 79(a) as group-term life insurance.

"Church" means a church or a convention or association of churches. "Employee" has the same meaning as for purposes of the rules relating to church pension plans.

EFFECTIVE DATE OF FEDERAL PROVISIONS

These provisions are retroactive and are effective as if included in the Deficit Reduction Act of 1984, (P.L. 98-369); i.e., generally for contracts issued after December 31, 1984.

STATE REVENUE IMPACT

Negligible revenue loss under state law.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE D: Insurance Provisions

ACTION: EXCLUDES FROM CORPORATION'S ADJUSTED CURRENT EARNINGS, FOR TAX PREFERENCE, INCOME ON AN ANNUITY CONTRACT THAT IS A QUALIFIED FUNDING ASSET AND INCOME THAT IS PART OF AN EMPLOYER'S QUALIFIED ANNUITY PLAN FOR ITS EMPLOYEES

Act Section 6079(a)

BACKGROUND

Both federal and state law impose an alternative minimum tax. The tax due for the taxable year is the tentative alternative minimum tax or the regular tax, whichever is greater (adjusted for certain credits). Alternative minimum taxable income (AMTI) is the corporation's regular taxable income (or loss), modified by certain adjustments, increased by specified tax preference items, and reduced by a phased-out exemption of $40,000.

For any tax year beginning after 1989, the alternative minimum taxable income of a corporation (other than an S corporation, regulated investment company, real estate investment trust or REMIC) is increased by 75 percent of the amount by which its "adjusted current earnings" exceed AMTI (determined without regard to the adjusted current earnings preference and the alternative minimum tax NOL deduction). The preference is to be taken into account regardless of whether the adjustments are positive or negative.

In computing "adjusted current earnings", a taxpayer must generally treat preference items in the same manner as required for computing alternative minimum taxable income. Certain items that are not taken into account for this purpose may be included in determining adjusted current earnings.

For regular income tax purposes, the income on an annuity contract held by a corporation or other nonnatural person is included in income. An exception to this rule of inclusion is provided in the case of income on an annuity contract that is a qualified funding asset under a structured settlement arrangement, without regard to whether there is a qualified assignment.

The adjusted current earnings provision of the corporate alternative minimum tax requires the inclusion of the income on any annuity contract. The adjusted current earnings provision does not incorporate the exception for annuity contracts that are qualified funding assets.

CURRENT CALIFORNIA LAW (Sec. 23400)

California law generally conforms to federal law.

NEW FEDERAL LAW (Sec. 56(g)(4)(B)(iii))

The Act amends federal law by providing that a corporation does not have to include in its tax preference for adjusted current earnings either income on an annuity contract that is a qualified funding asset (without considering whether there is a qualified assignment) or income on an annuity contract that is part of an employer's qualified annuity plan for its employees. This new rule simply mirrors the rule used to calculate regular taxation, under which income on an annuity contract held by a corporation is included in the corporation's income with some exceptions, including the exception for qualified funding assets and qualified annuity plans.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision is effective for taxable years beginning after December 31, 1989 (i.e., the effective date for the adjusted current earnings provision).

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, the comparable state revenue loss would be in the $500,000 range for 1990-91.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE D: Insurance Provisions

ACTION: TREATS A LIABILITY ASSIGNMENT AS A QUALIFIED ASSIGNMENT EVEN THOUGH RECIPIENT IS PROVIDED CREDITOR'S RIGHTS AGAINST THE ASSIGNEE GREATER THAN THOSE OF A GENERAL CREDITOR

Act Section 6079(b)

BACKGROUND

An exclusion from gross income is provided for amounts received for agreeing to a qualified assignment to the extent that the amount received does not exceed the aggregate cost of any qualified funding asset.

A qualified assignment means any assignment of a liability to make periodic payments as damages on account of a personal injury or sickness (in a case involving physical injury or physical sickness), provided the terms of the assignment satisfy certain requirements. Generally, these requirements are that (1) the periodic payments are fixed as to amount and time; (2) the payments cannot be accelerated, deferred, increased, or decreased by the recipient; (3) the assignee's obligation is no greater than that of the person assigning the liability; (4) the payments are excludable to the recipient as damages; and (5) the assignee does not provide to the recipient of such payments rights against the assignee that are greater than those of a general creditor.

CURRENT CALIFORNIA LAW (Sec. 17131)

California law is conformed to federal law.

NEW FEDERAL LAW (Sec. 130(c)(2)

Act Section 6079(b) deleted requirement (5), above, and added a new sentence at the end of paragraph (2) of Section 130(c) providing that a personal injury liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee that are greater than those of a general creditor.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision applies to liability assignments made after November 10, 1988.

STATE REVENUE IMPACT

State revenue impact would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE D: Insurance Provisions

ACTION: TREATS EACH AGENCY OR INSTRUMENTALITY OF THE UNITED STATES AS A SEPARATE ISSUER FOR PURPOSES OF THE DIVERSIFICATION REQUIREMENT IN THE TREATMENT OF VARIABLE ANNUITIES AND LIFE INSURANCE CONTRACTS

Act Section 6080

BACKGROUND

The owner of a variable annuity contract or variable life insurance contract that is based on a segregated asset account is subject to current taxation on the earnings of the contract if the underlying investments of the segregated asset account are not, under Treasury regulations, adequately diversified. IRS regulations treat obligations issued, guaranteed, or insured by a U.S. agency or instrumentality as a single investment. This treatment is burdensome to owners of variable annuity or variable life insurance contracts that are supported by segregated asset accounts, since the owners are currently taxed on earnings from the contracts if investments held by the accounts are not adequately diversified.

CURRENT CALIFORNIA LAW (Sec. 17020.6, 17085 and 23045)

The Personal Income Tax Law conforms to the tax treatment of annuities and life insurance contracts. Since IRS regulations provide that obligations issued, guaranteed, or insured by a U.S. agency or instrumentality are treated as a single instrument (the underlying investments are not diversified), the owners of such obligations are taxed on the earnings of those obligations.

NEW FEDERAL LAW (Sec. 817(h))

The Act provides that each agency or instrumentality of the United States is treated as a separate entity for purposes of the diversification requirement.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision is effective for taxable years beginning after December 31, 1988.

STATE REVENUE IMPACT

State revenue impact would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE E: Excise Tax Provisions

ACTION: VARIOUS EXCISE TAXES MODIFIED

Act Section 6101 - 6111

BACKGROUND

The federal government imposes excise taxes on such products as wine, gasoline, heavy trucks and trailers, distilled spirits and bows and arrows as well as user fees on industrial use of specially denatured distilled spirits, occupational taxes on distilled spirits plants and harbor maintenance taxes.

CURRENT CALIFORNIA LAW

The California tax laws administered by the Franchise Tax Board do not contain provisions comparable to the various provisions being modified by TAMRA.

NEW FEDERAL LAW

The Act modifies the excise taxes imposed on such products as wine, gasoline, heavy trucks and trailers, distilled spirits and bows and arrows as well as user fees on industrial use of specially denatured distilled spirits, occupational taxes on distilled spirits plants and harbor maintenance taxes.

STATE REVENUE IMPACT

These provisions are not applicable to the tax laws administered by the Franchise Tax Board.

TITLE IV: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: DUAL RESIDENT COMPANIES

Act Section 6126

BACKGROUND

Prior to the Tax Reform Act of 1986, certain U.S. companies subject to income tax in a foreign country on their income without regard to its source or on a residence basis, could consolidate with one set of affiliates in the United States and another set of affiliates in a foreign country simultaneously. This would enable the "dual resident" company with a net operating loss to offset two streams of income.

The Tax Reform Act of 1986 prevented the double use of losses that the prior law allowed. Therefore the loss of a dual resident company may be used to offset the income of a group of foreign affiliates but not its U.S. affiliates. Under U.S. and United Kingdom law, the loss may not be used to offset the income of any other affiliate whether U.S. or foreign. In order to restore the use of its losses, the company must reorganize in the U.K.

Such a reorganization may result in a taxable event if the U.S. parent has an "excess loss account". An excess loss account is created when the domestic company has distributions or losses which are in excess of the parent's basis in the stock.

CURRENT CALIFORNIA LAW

California Bank and Corporation Law does not contain a provision for dual resident corporations. Under the unitary method of taxation, all corporations that are operating a unitary business with a taxpayer must be included in the combined report, therefore any loss sustained by a member of the combined group would offset the combined income.

Under the water's edge method of filing, a corporation will be included in the water's edge combined report if it is incorporated in the United States (with the exception of corporations making an election pursuant to Sections 931 to 936 inclusive of the Internal Revenue Code) whose property, payroll and sales percentages are less than 20 percent within the U.S. The corporation does not have to be included in a federal consolidated return. Therefore any loss sustained by a dual resident corporation will offset the water's edge combined income.

NEW FEDERAL LAW (noncode provision)

Under TAMRA, a U.S. corporation that has an excess loss account which arose prior to January 1, 1988 and while the corporation was a dual resident company would be allowed to reorganize as a foreign corporation without subjecting the parent to taxes on said excess loss account. The excess loss account would be "suspended" until the corporation was sold outside the affiliated group.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision would be effective for transactions occurring after November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE IV Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: ELECTION OF A PASSIVE FOREIGN INVESTMENT COMPANY TO BE TREATED AS A QUALIFIED ELECTING FUND

Act Section 6127

BACKGROUND

Under prior law, an election to treat a passive foreign investment company (PFIC) as a qualified electing fund must be made by the company, not the investor.

CURRENT CALIFORNIA LAW (Sec. 24995)

California Bank and Corporation Tax Law specifies that the federal rules relating to passive foreign investment companies do not apply.

If over 50 percent of the voting stock of the PFIC or qualified electing fund is owned directly or indirectly by a California corporate taxpayer it is subject to the corporate rules which are summarized below. Under the unitary method of taxation, all corporations that are operating a unitary business with a taxpayer must be included in the combined report.

Under the water's edge method of filing, a foreign corporation will be included in whole in the water's edge combined report if its property, payroll and sales percentages are 20 percent or more within the U.S. Controlled foreign corporations that have Subpart F income are included in part in the water's edge combined report at the ratio that Subpart F income bears to earnings and profits for the current year. Other foreign corporations are included in the water's edge combined report to the extent that they have income which is effectively connected or which is treated as being effectively connected with a U.S. trade or business.

NEW FEDERAL LAW (Sec. 1291(d) and 1295)

Under TAMRA, a U.S. shareholder of a passive foreign investment income company (PFIC) may elect to have the PFIC treated as a qualified electing fund for purposes of that shareholder. An election at this level is available only when the PFIC complies with certain criteria listed in the revised regulations. The effect of the election is that the U.S. shareholder will not be subject to the interest charge on tax deferral (IRS Section 1291). Once an election is made it is in effect unless it is revoked by the investor with the consent of the Secretary of the Treasury. In addition, if the investor liquidates its holdings in a PFIC, the election remains in effect should the investor reinvest in the PFIC in a later taxable year.

The investor may make the election on or before the due date of its tax return. If the investor does not make an election because it believe that the company is not an eligible PFIC, but it is later determined through an IRS audit that the company is eligible, the regulations provide for a retroactive election.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for tax years beginning after December 31, 1986.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: INCREASES DEBT EQUITY RATIO ALLOWED IN DEFINING A FOREIGN CORPORATION'S RESIDENCY STATUS

Act Section 6128

BACKGROUND

The 1984 Deficit Reduction Act (in a noncode provision) set the maximum debt to equity ratio at 5 to 1 as part of the determination of whether the country of incorporation could be used as the corporation's country of residence. These rules applied to controlled foreign corporations (CFC's) and in particular the Netherlands Antilles Finance Subsidiaries of U.S. corporations.

CURRENT CALIFORNIA LAW

California did not conform to the noncode provision enacted by the 1984 Deficit Reduction Act. California utilizes the unitary method to determine the portion of the business income of domestic parents with foreign subsidiaries which is subject to state franchise tax.

NEW FEDERAL LAW (Act Sec. 6128)

This noncode provision in the Act changes the ratio of 5 to 1 contained in the 1984 Deficit Reduction Act to 25 to 1 thus allowing more of these finance subsidiaries to be considered as foreign versus domestic corporations. Also, this change has the effect of allowing a fivefold increase in the corporation's debt.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Effective for taxable years ending after November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: MODIFIES RULES FOR FOREIGN CURRENCY TRANSACTIONS

Act Section 6130

BACKGROUND

Under pre-1988 federal law ordinary income and loss characterization rules apply to certain gains and losses on foreign currency-related forward contracts, futures contracts, options, and similar financial instruments, unless those instruments are marked to market at year-end. At the taxpayer's election, gain or loss on a forward, future, or option which is a capital asset in the hands of the taxpayer, is not part of a straddle, and is identified by the taxpayer before the close of the day on which it is entered into, is capital, and not ordinary. See an in depth explanation in CCH paragraph 3170.

CURRENT CALIFORNIA LAW (Sec. 17078 and 24905)

California is conformed to federal law.

NEW FEDERAL LAW (Sec. 988 and 1092)

TAMRA retains current law (as amended to take into account numerous technical corrections) of regulated future contacts and nonequity options by not treating them as foreign currency transactions if they are marked to market at year end but allows the taxpayer to elect to treat them as foreign currency transactions.

Foreign currency related forwards and similar financial instruments are to be treated under the foreign currency rules whether they are marked to market at year end or not and thus, generally will be treated as ordinary income and not capital gain. Special rules are provided for a capital gain election as well as creating a special class of partnerships called "qualified funds" to receive capital gain treatment on certain forwards and futures which would otherwise be foreign currency transactions under the general rule.

Regulatory authority is expanded with regard to mixed straddles to include the issues of timing and character of gains and losses. A mixed straddle is one where at least one position would produce ordinary income and at least one position would produce capital gain.

EFFECTIVE DATE OF FEDERAL PROVISIONS

These provisions are generally effective for contracts acquired or entered into after October 21, 1988.

STATE REVENUE IMPACT

No identifiable revenue effect.

TITLE IV: Other Substantive Revenue Changes

SUBTITLE F: Foreign Provisions

ACTION: VIRGIN ISLANDS TREATED AS QUALIFIED BASIN COUNTRY

Act Section 6132

BACKGROUND

The Puerto Rico and possession tax credit was originally enacted for the purpose of promoting American trade in the U.S. possessions and to afford U.S. citizens and domestic corporations an equal opportunity to compete with foreign individuals and foreign corporations. The Tax Reform Act of 1986 expanded the definition of "possession" to include the U.S. Virgin Islands.

Certain electing U.S. corporations engaged in a business in a Caribbean Basin country can take a possession tax credit on Qualified Possession Source Investment Income (QPSII). QPSII must be attributable to an investment where a trade or business is conducted within the Caribbean Basin country.

Prior to TAMRA, corporations doing business in the Virgin Islands may still elect IRC Section 936 without being considered Caribbean Basin countries, however they may not take a tax credit based on QPSII.

CURRENT CALIFORNIA LAW

California Bank and Corporation Tax Law does not contain a provision for tax credits for corporations earning QPSII. Under the unitary method of taxation, all corporations that are operating a unitary business with a taxpayer must be included in the combined report. Under the water's edge method of filing, all corporations electing IRC Section 936 status are excluded from the water's edge combine report, unless the corporation has more the 20 percent of its property, payroll and sales within the United States.

NEW FEDERAL LAW (Sec. 936(D)(4)(B))

Under TAMRA, the U.S. Virgin Islands would be considered a Caribbean Basin country for determining whether investments in financial intermediaries give rise to QPSII.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The enactment date applies to investments made after November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: EXTENDS PROVISIONS FOR THE TREATMENT OF PORTFOLIO INTEREST OF U.S. OBLIGATIONS HELD BY POSSESSION BANKS

Act Section 6133

BACKGROUND

Under prior federal law, certain non-Guamanian possession banks were subject to net-basis U.S. income taxes and branch level taxes with respect to interest from U.S. obligations, regardless of whether such banks had an actual trade or business in the U.S. On the other hand, foreign banks without U.S. trades or businesses were not subject to these U.S. taxes.

This Act extends the same treatment of U.S. government interest to possession banks as is applicable to foreign banks.

CURRENT CALIFORNIA LAW

California law has no comparable provision regarding taxation of foreign banks or financial corporations.

U.S. government interest is includable in income for purposes of the California franchise tax. The franchise tax applies to banks and financial corporations as well as general corporations doing business within California.

NEW FEDERAL LAW (Sec. 882(e))

Under the new provision, federal law is amended to extend the treatment of interest on U.S. obligations to banks organized and doing business in any U.S. possession, as follows:

1. would not be subject to net-basis U.S. income taxation on interest on U.S. obligations that is portfolio interest, and

2. they would not be subject to the branch-level taxes on earnings that arise from, and interest expense that is allocated against, interest income from U.S. obligations derived from those banks (unless they are engaged in a U.S. trade or business and the business interest is actually effectively connected therewith).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for taxable years beginning after December 31, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: CODIFIES THE CURRENT IRS PRACTICE OF NOT COLLECTING FROM GAMBLING CASINOS THE 30 PERCENT WITHHOLDING TAX ON U.S. GAMBLING WINNINGS OF NONRESIDENT ALIENS FROM CERTAIN TABLE GAMES

Act Section 6134

BACKGROUND

Under current federal law, a 30 percent withholding tax is imposed on certain gambling winnings of nonresident aliens. The Internal Revenue Service, with some exceptions, collects withholding taxes on gambling winnings of nonresident aliens from slot machines, keno, pari-mutuel games, bingo and pull-tab games. The winnings from "table games" are also included.

Congress enacted a new provision based on the Internal Revenue Service's findings that collecting withholding from nonresident aliens of certain table game winnings is administratively infeasible and no 30% withholding was collected from nonresident aliens from certain table games. To collect the taxes would substantially change current gaming casino practice if the amount of winnings paid at table games was dependent on the winner's residence.

CURRENT CALIFORNIA LAW (Sec. 18805 and Government Code Sec. 8880.68)

Currently, California does not have a specific provision which imposes a withholding of California tax from gambling winnings. Although California law authorizes the Franchise Tax Board to require withholding of personal income tax from payments of interest, rent, dividends, annuities, prizes, and winnings as well as payments for personal services in general, the FTB has required withholding at the source only from personal service income of nonresidents. Occasionally the provision has been applied to prizes and winnings paid to nonresidents.

In addition, a special exemption is provided for winnings awarded by the California State Lottery. The Government Code provides that lottery prizes are exempt from state and local taxes.

NEW FEDERAL LAW (Sec. 871(j) and 1441(c))

Under the new federal provision, the 30 percent withholding tax imposed on United States source gambling winnings will not apply to the gambling winnings of nonresident aliens from blackjack, roulette, baccarat, craps and the big six wheel. However, should the collection of tax become more feasible, the Treasury can issue regulations reimposing the withholding tax on the winnings of these table games. Imposition of the tax would apply where withholding wouldn't be disruptive to the casino's operation as the games are now played.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to gambling winnings received on or after November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE IV: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: ELECTION OF DOMESTIC CORPORATION TREATMENT BY FOREIGN INSURANCE COMPANY

Act Section 6135

BACKGROUND

Under present law, foreign corporations engaged in the insurance business in the United States are subject to a branch tax, even if they are controlled by U.S. persons. If the corporation reorganizes and incorporates as a U.S. corporation they would avoid the branch tax but be subject to a tax on their accumulated earnings and profits.

CURRENT CALIFORNIA LAW

California Bank and Corporation Tax Law does not contain a provision for taxation of insurance companies. Instead, they are subject to a gross premium tax.

NEW FEDERAL LAW (Sec. 953(d))

Under TAMRA, a controlled foreign corporation engaged in the insurance business can make an election to be treated as a domestic corporation avoiding branch taxes. Dividends paid by the electing corporation would be eligible for the dividends received deduction to the extent they are paid out of earnings and profits for the period the election was in effect. In lieu of paying the immediate accumulated earnings tax on earnings and profits accumulated prior to the election, the electing corporation will pay a tax of three quarters of one percent of capital and surplus (limited to $1,500,000).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision would be effective for taxable years beginning after December 31, 1987.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: EXEMPTS FROM FEDERAL, STATE, AND LOCAL TAXATION DISTRIBUTIONS FROM THE ENJEBI COMMUNITY TRUST FUND

Act Section 6136

BACKGROUND

The Enjebi Community Trust Fund was established in Section 103(k) of the Compact of Free Association Act of 1985 (P.L. 99-239) to provide a means of financing the future rehabilitation of Enjebi Island in the Enewetak Atoll, which was the site of nuclear weapons tests that were conducted in the 1940s and 1950s.

CURRENT CALIFORNIA LAW (Sec. 17041(a) and (c), 17742, 25108 and 25123-25126)

California residents, estates (if the decedent was a California resident), and trusts (if the fiduciary or beneficiary is a California resident), are taxable on income from all sources. A corporation whose commercial domicile is in California is taxable on nonbusiness income from sources outside of California.

NEW FEDERAL LAW (Act Sec. 6136)

Act Section 6136 adds a noncode provision, providing that any earnings on, and distributions from, the Enjebi Community Trust Fund, created under Section 103 of the Compact of Free Association Act of 1985, shall be exempt from all federal, state and local taxation.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision applies to all taxable years whether beginning before, on or after November 10, 1988.

STATE REVENUE IMPACT

Negligible revenue loss, if any.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: PROVIDES AN EXCLUSION FOR COST-OF-LIVING ALLOWANCES RECEIVED BY JUDICIAL EMPLOYEES SERVING ABROAD

Act Section 6137

BACKGROUND

Under IRC Section 912, cost-of-living allowances for civilian officers and employees of the U.S. government stationed outside the contiguous 48 states and the District of Columbia are excludable from gross income if they are received under regulations approved by the President. Since October 12, 1987, COLAs received by employees of the judicial branch of the government have not been excludable from income because, technically, they have not been received under regulations approved by the President.

CURRENT CALIFORNIA LAW (Sec. 17024.b(b)(8))

The provisions of the Internal Revenue Code relating to United States citizens living abroad are not applicable. These individuals would, however, normally be nonresidents of California and, therefore, are not taxable on income earned from sources outside of this state.

NEW FEDERAL LAW (Sec 912(2))

The Act corrects the inequity for judicial employees by allowing them to exclude from gross income cost-of-living allowances received after October 12, 1987, if they were received either under regulations approved by the President or under certain other pay scales or salary plans approved by the President.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision applies to allowances received after October 12, 1987, in tax years ending after that date.

STATE REVENUE IMPACT

Not applicable. For California residents all income, irrespective of where it is earned, is considered for tax purposes; for nonresidents, only income attributable to California sources is considered.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: REQUIRES A STUDY OF THE DEFINITION OF A RESIDENT ALIEN BY TREASURY DEPARTMENT

Act Section 6138

BACKGROUND

Federal law contains a provision which defines a resident/nonresident alien. In order to broaden the definition, Congress has required the Treasury Department to complete an in-depth study regarding the effects of a change on federal tax administration, U.S. treaty obligations, U.S. trading partners, and revenue impact.

CURRENT CALIFORNIA LAW (Sec. 17024.5(b)(11))

California specifically makes federal provisions relating to resident and nonresident aliens of the United States not applicable for California purposes.

NEW FEDERAL LAW (noncode provision)

Under the new provision, the Treasury Department is required to complete a study of the Code definition of resident alien. The Study is to examine the following:

1. The effect that the determination of whether a person is a United States resident has on federal tax administration and investment flows between the United States and foreign countries,

2. The coordination of the definition with United States treaty obligations,

3. How the rules for making the determination of resident alien status compare with those rules used by United States trading partners, and

4. The estimated revenue impact of changing the definition.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The study is to be completed before May 1, 1989.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: EXEMPTS THE BERMUDA AND BARBADOS INCOME TAX TREATIES FROM THE PROVISION BARRING THE APPLICATION OF THE U.S. GROSS BASIS EXCISE TAX FOR INSURANCE PREMIUMS

Act Section 6139

BACKGROUND

The Internal Revenue Code provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation. For purposes of applying any exemption from, or reduction of, any tax provided by any treaty to which the United States is a party with respect to income which is not effectively connected with the conduct of a trade or business within the United States, a nonresident alien individual or a foreign corporation shall be deemed not to have a permanent establishment in the United States at any time during the taxable year.

CURRENT CALIFORNIA LAW (None)

California is not bound by any treaties with foreign governments entered into by the United States government, as they affect the income tax laws of this state. California residents, estates (if the decedent was a California resident), and trusts (if the fiduciary or beneficiary is a California resident), are taxable on income from all sources. A corporation whose commercial domicile is in California is taxable on nonbusiness income from sources outside of California.

NEW FEDERAL LAW (Act Sec. 6139)

This noncode provision in the Act provides that none of the provisions of the Tax Convention with the United Kingdom (on behalf of Bermuda) or the Tax Convention with Barbados, if either or both are in force on December 31, 1989, shall prevent application of any provision of the Internal Revenue Code of 1986 imposing insurance excise taxes. In the case of a treaty entered into after November 10, 1988 (the date of enactment of TAMRA), this prohibition will not apply if the treaty by specific reference to this section of this Act clearly expresses the intent to override the provisions of this section. In the case of any treaty in effect on December 31, 1989, this provision shall apply to any premium, regardless of when paid, that is allocable to insurance coverage for periods after December 31, 1989.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision became operative November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE IV: Other Substantive Revenue Provisions

SUBTITLE F: Foreign Provisions

ACTION: AWARDS BY GUAM DISTRICT COURT

Act Section 6140

BACKGROUND

If an individual is a bona fide resident of Guam, their income will not include any income derived from sources within Guam or any income which is effectively connected from a trade or business that is conducted within Guam. An individual shall not be allowed any deduction or credits attributable to such income.

If a corporation created or organized within Guam is to be treated as a foreign corporation, then it will be subject to the rules stated in IRC Section 884. If the corporation is to be treated as a domestic corporation, then it would be treated as if it were operating within the U.S. A corporation created or organized in Guam will be treated as a domestic corporation if it meets the following criteria:

1. at all times during such taxable year less the 25 percent of the stock is owned (directly or indirectly) by foreign persons,

2. at least 65 percent of the gross income of the corporation is effectively connected with the conduct of a trade or business in such a possession for the three year period ending with the close of the current taxable year, and

3. no substantial part of the income of the corporation is used (directly or indirectly) to satisfy obligations of persons who are not bona fide residents of Guam.

CURRENT CALIFORNIA LAW

Neither California Personal Income Tax Law nor California Bank and Corporate Tax Law contain any provisions for possession corporations. Under the unitary method of taxation, a corporation incorporated in Guam that is operating a unitary business with a taxpayer must be included in the combined report.

Under the water's edge method of filing, a corporation incorporated in Guam will be included in the water's edge combined report, provided the corporation has 20 percent or more of its average property, payroll and sales percentages within the U.S. Controlled foreign corporations that have Subpart F income are included in the water's edge combined report at the ratio that Subpart F income bears to earnings and profits for the current year. Foreign corporations are included in the water's edge report to the extent that they have income which is effectively connected or which is treated as effectively connected with a U.S. trade or business.

NEW FEDERAL LAW (noncode provision)

Amounts received under any claim under the jurisdiction of the District Court of Guam by virtue of Section 204 of the Omnibus Territories Act of 1977 are excluded from gross income for purposes of the Internal Revenue Laws of both the U.S. and Guam.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The exclusion is effective for tax years beginning after 1985.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE G: Estate Tax Provisions

ACTION: SPECIAL USE VALUATION NOT TERMINATED FOR RENTAL OF PROPERTY TO MEMBER OF SURVIVING SPOUSE'S FAMILY

Act Section 6151

BACKGROUND

Federal law imposes an Estate Tax on the value of assets in the estate of decedents. Special use valuation terminates when the property is no longer used for qualified purposes. As part of the federal system a credit is allowed for state taxes paid by the estate.

CURRENT CALIFORNIA LAW

California imposes an estate tax equal to the highest amount of credit allowable for the federal estate tax. This tax is called the "pick-up tax" which in administered by the State Controller's Office.

NEW FEDERAL LAW (Sec. 2032A)

This act makes changes to the federal estate tax relating to special use valuation, to provide an exception for certain rents.

A surviving spouse's cash rental of specially valued real property to a member of the spouse's family will not be treated as a recapture event, i.e., the property will not be considered to have ceased to be treated in a qualified use.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to rentals occurring after December 31, 1976. The statute of limitations will be waived with respect to claims filed by November 10, 1989.

STATE REVENUE IMPACT

Determination of the amount of any change in estate tax "pick-up" revenue at the state level would require analysis by the State Controller's Office.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE G: Estate Tax Provisions

ACTION: CLARIFIES THE TREATMENT OF JOINT AND SURVIVOR ANNUITIES UNDER QTIP RULES FOR FEDERAL ESTATE AND GIFT TAX PURPOSES

Act Section 6152

BACKGROUND

The federal gift tax applies to gifts of property to the extent that the value of the gifts exceeds permitted deductions. A taxable gift generally occurs with respect to an annuity when the donor irrevocably designates a beneficiary.

A marital deduction is allowed for federal estate and gift tax purposes for an interest in property passing to a spouse if that interest is not terminable (i.e., it does not terminate and pass to a person other than the spouse). A special rule applicable to qualified terminable interest property (QTIP) allows a marital deduction where (1) the donee spouse only has an income interest in the property; (2) an election is made to include the property in his or her estate and (3) any federal estate tax is paid out of the QTIP.

CURRENT CALIFORNIA LAW

Both the California inheritance tax and the gift tax laws were repealed on June 8, 1982. However, California still imposes two death taxes: (1) the estate tax (Part 8 of Division 2 of the Revenue and Taxation Code, and (2) the generation-skipping transfer tax (Part 9.5 of Division 2 of the Revenue and Taxation Code). Both are so called "pick-up" taxes that simply collect a tax that would otherwise go to the federal government. They obtain for the state the maximum benefit for the federal credits that are allowed for state taxes.

NEW FEDERAL LAW (Sec. 2056(b)(7) and 2523(f))

The Act provides that the transfer to a spouse of an interest in a joint and survivor annuity in which only the spouses have the right to receive any payments prior to the death of the last spouse generally qualifies for a marital deduction for federal estate and gift tax purposes. However, such a transfer does not qualify if either the donor or the executor irrevocably elects out of qualified terminable interest property (QTIP) treatment. The donor's subsequent transfer of an interest in the annuity is treated as a transfer of such interest. The donee's subsequent transfer of an interest in the annuity is treated as a transfer of all interest in the annuity other than the donor's interest. If the donee dies before the donor, no amount with respect to the annuity is includible in the estate of the donee.

EFFECTIVE DATE OF FEDERAL PROVISION

This provision is generally effective for decedents dying, and transfers made after December 31, 1981. For any estate or gift tax return filed before the November 10, 1988, the date of enactment of

TAMRA, this provision does not apply to the extent inconsistent with the prior return unless the executor or donor otherwise elects such treatment within two years after the date of enactment. The time for election out of QTIP treatment does not expire prior to November 10, 1990, two years after date of enactment.

STATE REVENUE IMPACT

Not applicable under Personal Income Tax Law.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-exempt Bond Provision

ACTION: CLARIFIES THE DEFINITION OF MANUFACTURING FACILITY FOR QUALIFIED SMALL-ISSUE BONDS

Act Section 6176

BACKGROUND

For federal purposes interest on State and local government bonds generally is tax-exempt. However, interest on private activity bonds issued by such governments are taxable unless a specific exemption is provided in the Code. Federal law currently grants tax-exempt status to certain "small issues" of State and local bonds that would otherwise be taxable as private activity bonds (for bonds issued after August 15, 1986). These bonds are part of qualifying "small issues" which are called "qualified small issue bonds", and constitute tax-exempt "qualified bonds".

The qualified small issue bonds may be issued to finance a manufacturing facility only. The authority to issue these bonds is scheduled to expire after December 31, 1989. A manufacturing facility is defined as one that is used to produce tangible personal property, including the processing that would result in a change in such property.

CURRENT CALIFORNIA LAW (Sec. 17143)

California does not have a provision which defines qualified small issue bonds for manufacturing facilities. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (Sec. 144(a)(12))

The new federal law clarifies the definition of a manufacturing facility. The law states that a "manufacturing facility" includes facilities that are directly related and ancillary to a manufacturing facility if:

1. such facilities are located at the same site as the manufacturing facility, and

2. not more than 25 percent of the net proceeds of the qualified issue are used to provide such facilities.

All ancillary activities must occur at the same site as the manufacturing activity, and manufacturing must constitute substantially all of the on-site economic activity. All other activities must be subordinate to and integral to the manufacturing process.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision generally applies to bonds issued after November 10, 1988.

STATE REVENUE IMPACT

Not applicable to California's tax-exempt bond provisions.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-exempt Bond Provisions

ACTION: AMENDS THE TAX AND REVENUE ANTICIPATION NOTES (TRAN) ARBITRAGE REBATE SAFE HARBOR BY EXTENDING THE MINIMUM PERIOD FOR DETERMINING THE CASH FLOW DEFICIT

Act Section 6177

BACKGROUND

The Tax Reform Act of 1986 restructured and amended the rules governing tax exemption for interest on bonds issued after August 15, 1986. Interest on state and local government bonds generally is tax-exempt. However, bond interest in not tax-exempt when it is derived from nonexempt private activity bonds, state or local bonds that have not been issued in registered form, or arbitrage bonds.

Any investment with respect to which impermissible arbitrage earnings accrue may result in the interest on the issue becoming taxable to the issuee, retroactive to the date the issue was issued. For example, if after the expiration of an allowable temporary period, the issuer continues to invest the bond proceeds at a materially higher yield in order to earn impermissible arbitrage, interest on the bonds is taxable.

To qualify for tax exemption, certain arbitrage restrictions must be satisfied with respect to the earnings on bond proceeds. Certain arbitrage profits earned on "nonpurpose investments" acquired with the gross proceeds of any tax-exempt bond must be rebated to the United States. "Nonpurpose investments" include all obligations other than those specifically acquired to carry out the governmental purpose for which the bonds are issued.

As described above, arbitrage profits on all tax-exempt bonds, including tax and revenue anticipation notes (TRANs) issued to fund cash-flow shortfalls of governmental units, generally must be rebated to the Federal Government if all gross proceeds of an issue are not spent for the exempt purpose of the borrowing unit within six months of the date of issuance. The Tax Reform Act of 1986 provided a special safe harbor exception for TRANs pursuant to which all gross proceeds are deemed to have been spent for the exempt purpose of the borrowing unit within six months.

Under this safe harbor, TRAN net proceeds are treated as so spent if the issuer's cumulative cash-flow deficit for the period beginning on the date the notes are issued and ending on the earliest of (a) the maturity date of the TRANs, (b) the date that is six months after the TRANs are issued, or (c) the date of computation of the issuer's cash-flow deficit, exceeds 90 percent of the TRAN proceeds. Solely for the purpose of this safe harbor, cumulative cash-flow deficit is defined as the excess of the amount the government unit spends during the relevant period over the sum of all amounts (other than the issue proceeds) that are available for payment of the expenses during that period.

Most (if not all) gross proceeds of TRANs having a maturity of less than six months must be rebated to the Federal Government. This conclusion is based on the following analysis:

> For TRANs having a maturity date of less than six months, the issuer's cumulative cash-flow deficit would be calculated for the period beginning on the date the notes are issued and ending on the maturity date (earliest of (a) the maturity date, or (b) the date that is six months after the TRANs are issued, or (c) the date of computation of the issuer's cash-flow deficit) of the TRANs. The issuer's cumulative cash-flow deficit would not exceed 90 percent of the TRAN proceeds at this date; therefore, the gross proceeds are not deemed to have been spent for the exempt purpose of the borrowing unit. In order to keep the tax-exempt status for the issuee, the gross proceeds would have to be rebated to the Federal Government.

In an attempt to make the rules more flexible for TRANs having a maturity of less than six months, a provision was enacted to extend the period for determining whether arbitrage proceeds were used for governmental purposes under the safe harbor.

<u>CURRENT CALIFORNIA LAW</u> (Sec. 17143)

California does not have a provision which relates to tax and revenue anticipation notes (TRANs). Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

<u>NEW FEDERAL LAW</u> (Sec. 148(f)(4)(B)(iii) and 148(f)(3))

The new federal law amends the TRAN arbitrage rebate safe harbor by extending the minimum period for determining the cash-flow deficit in the case of TRANs having a maturity of less than six months. For these TRANs, the period for determining the issuer's cumulative cash-flow deficit will be the period beginning on the date of issuance of the bonds and ending on the earlier of:

1. the date that is six months after the TRANs are issued or

2. the actual date the issuer's cash-flow deficit exceeds 90 percent of the TRANs proceeds.

The provision does not affect the determination of whether an issuer qualifies for a temporary period during which higher yielding investments must be made. Therefore, to qualify for a temporary period, issuers must continue to satisfy the cumulative cash-flow deficit calculated before the maturity date of each TRAN issue.

The provision also amends the due date of the final rebate payment on TRAN issues that have a maturity of less than six months. The final rebate payment is due no earlier than eight months after the date of issue.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision generally applies to tax and revenue anticipation notes issued after November 10, 1988.

STATE REVENUE IMPACT

Not applicable to California's tax-exempt provisions.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-exempt Bond Provisions

ACTION: AMENDS MORTGAGE BOND PURCHASE PRICE REGULATIONS

Act Section 6178

BACKGROUND

Currently, under federal regulations relating to mortgage bond purchase price requirements, an issue meets the requirements only if the acquisition cost of each residence, other than a targeted area residence, for which owner financing is provided does not exceed 90 percent of the average area purchase price applicable to such residence. In the case of a targeted area residence, the acquisition cost may not exceed 110 percent of the average area purchase price applicable to such residence.

CURRENT CALIFORNIA LAW

California does not have or need comparable purchase price regulations. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (noncode provision)

The new provision requires the Treasury Department to amend its tax-exempt mortgage bond purchase price regulations to provide that the capitalized value of a ground lease is equal to the present value of the current ground rent projected over the remaining term of the lease and discounted at 3 percent or at a discount rate established by the IRS. This provision applies to leases having at least 35 years remaining and a specified ground rent is known for at least the first 10 years of the term, but not for the entire term.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision generally applies to bonds issued on or after November 10, 1988.

STATE REVEUNE IMPACT

Not applicable.

TITLE V: Other Substantive Revenue Provisions

SUBTITLE H: Tax-exempt Bond Provisions

ACTION: CLARIFIES THE TAX STATUS OF HAZARDOUS-ACTIVITY BONDS.

Act Section 6179

BACKGROUND

For federal income tax purposes, State and local governments may issue tax-exempt bonds to finance governmental activities, but may issue tax-exempt private activity bonds only for specified purposes. Under present law, private activity bonds are any bonds issued as part of an issue which meets:

1. the private business use test and the private security or payment test, or

2. the private loan financing test.

Interest on certain exempt facility bonds issued by or on behalf of qualified governmental units may be tax-exempt even though the above tests for private activity bonds are not satisfied. Included in the list of exempt facilities eligible for tax-exempt financing are qualified hazardous waste disposal facilities.

Hazardous waste disposal facilities include facilities for the land incineration or the permanent entombment of hazardous waste when such facilities are subject to final permit requirements under the Solid Waste Disposal Act. Tax-exempt financing is available only for facilities (or the portion of a facility) used to dispose of hazardous waste generated by the public, as opposed to the owner or operator of the facility or a person related to the owner or operator.

Congress enacted a new provision to provide assistance to states that are considering the issuance of bonds to finance hazardous waste clean-up activities on private property. Currently, present law is unclear as to whether these bonds are governmental bonds if the proceeds are used to finance activities on privately owned land and reimbursement may be sought from private parties.

CURRENT CALIFORNIA LAW

California does not have a provision which relates to private activity bonds for hazardous waste activities. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issues by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (noncode provision)

The new provision requires the Treasury Department to provide guidelines clarifying the tax status of hazardous-activity bonds where some activities occur on privately owned land. The guidance is to address the application of the private activity bond test to tax-exempt bond financing for state programs that finance hazardous waste cleanup activities.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The Treasury Department must provide the guidelines before January 1, 1989.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-exempt Bond Provisions

ACTION: EXPANDS EXEMPT-FACILITY BONDS TO INCLUDE HIGH-SPEED RAIL ACTIVITIES

Act Section 6180

BACKGROUND

For federal income tax purposes, qualified governmental units may provide tax-exempt financing for certain nongovernmental activities. Bonds for activities of nongovernmental persons are referred to collectively as private activity bonds. All private activity bonds involve a use of bond proceeds or bond-financed property by, or a loan of bond proceeds to, a person other than a governmental unit, which use or loan exceeds a specified portion of the proceeds. Unlike financing for governmental operations, interest on private activity bonds is taxable unless a specific exception is provided.

Private activity bonds qualifying for tax-exemption include, among others, exempt-facility bonds. These type of bonds are issued to finance specific categories of exempt activities. Some of these activities include:

1. airports,
2. docks and wharves,
3. mass commuting facilities,
4. water, sewage and solid waste facilities,
5. local electrical and gas energy systems,
6. hazardous waste facilities, and
7. qualified residential properties.

In order for bonds issued for these activities to be considered tax-exempt, 95 percent of the bond proceeds must be used to finance the activity for which they were issued.

Congress has enacted several provisions for the tax-exempt status of bonds in order to stimulate private enterprise to develop projects which generally benefit the general public.

CURRENT CALIFORNIA LAW

California does not have a provision which relates to exempt-facility bonds. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (Sec. 142(i))

The new provision adds high-speed intercity rail facilities as another category of exempt-facility bond. This provision allows privately owned high-speed rail facilities to be financed by tax-exempt bonds. The bonds can provide funding for any facility for fixed guideway rail transportation for the benefit of the general public.

The term "high-speed rail facility" includes ground transportation facilities which utilize magnetic levitation technology. To be a qualifying facility, it must be reasonably expected that trains, carrying passengers and their baggage, will operate on the rail facility that is bond financed at average speeds in excess of 150 miles per hour between stations.

High-speed intercity rail facilities bonds are treated like airport exempt facility bonds, with exceptions. One exception provides that facilities financed by these bonds do not have to be governmentally owned. However, any owner that is not a governmental unit must make an irrevocable election not to claim depreciation or any credit on any property financed from the tax-exempt bond issue. Also, any proceeds from the issue that are not exhausted within three years from the issue date must be used to redeem outstanding bonds. Finally, twenty-five percent of each issue must receive an allocation subject to the State private activity bond volume limitation.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to bonds issued after November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-Exempt Bond Provisions

ACTION: AMENDS THE ARBITRAGE REBATE REQUIREMENT RELATING TO EARNINGS ON BONA FIDE DEBT SERVICE FUND

Act Section 6181

BACKGROUND

For federal income tax purposes certain arbitrage profits earned on "nonpurpose investments" acquired with the gross proceeds of any tax-exempt bond must be rebated to the United States. "Nonpurpose investments" include all obligations other than those specifically acquired to carry out the governmental purpose for which the bonds are issued. Obligations invested in a debt service reserve fund or in an escrow account established with the proceeds of a refunding issue are considered to be "nonpurpose investments".

The Tax Reform Act of 1986 provided five exceptions under which the rebate requirement does not apply. One of the exceptions provides for certain temporary investments related to debt service. Under this exception, if less than $100,000 is earned on a bona fide debt service fund in a bond year with respect to an issue, arbitrage profits earned on the fund in that year are not subject to the rebate requirement, unless the issuer elects to consider such amount when determining the amount of the rebate otherwise due with respect to the issue. This election must be made at the time of, or before, issuance of the bonds, and the election, once made, is irrevocable.

CURRENT CALIFORNIA LAW

California does not have a provision which relates to arbitrage earnings invested in a bona fide debt service fund. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (Sec. 148(f)(4)(A))

The new provision makes the exempt treatment of arbitrage profits on amounts invested in a bona fide debt service fund mandatory rather than elective. Also, the provision provides that the $100,000 gross earnings limitation does not apply to governmental issues, other than private activity bonds, having a weighted average maturity of five years or more and bearing interest at rates that do not vary during the term of the bonds.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to bonds issued after November 10, 1988. Also, issuers of outstanding governmental bonds, other than private activity bonds, are allowed a one-time election to apply the new rules to amounts deposited after November 10, 1988 in bona fide debt service funds for bonds issued after August 31, 1986.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-Exempt Bond Provisions

ACTION: MODIFIES THE TAX-EXEMPT TREATMENT OF BONDS ISSUED BY VOLUNTEER FIRE DEPARTMENTS

Act Section 6182

BACKGROUND

Currently, for federal income tax purposes, certain volunteer fire departments are allowed to issue tax-exempt bonds to finance qualified expenditures such as firehouses and firetrucks. The tax-exempt bonds can only be issued if the fire department is the only organization providing firefighting services to the area in which they serve, and if they are required by written agreement with the government to provide such a service. The net proceeds of the bond issue must be used to finance 95 percent or more of the qualified expenditures for which they were issued. The bond proceeds cannot be used to finance any portion of land in which a firehouse is to be located.

Under the Tax Reform Act of 1986, it was unclear whether bonds issued by volunteer fire departments were considered private activity bonds or governmental bonds. Therefore, Congress enacted a new provision clarifying the treatment of these bonds.

CURRENT CALIFORNIA LAW

California does not have a provision which relates directly to the tax-exempt treatment of bonds issued by volunteer fire departments. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (Sec. 150(e))

The new provision essentially treats these bonds as governmental bonds except that they require public approval and advance refunding is prohibited. The requirement that a volunteer fire department must provide exclusive firefighting services within a certain service area is modified to provide an exception where the governmental unit being served has been receiving continuous and exclusive service in the area by more than one qualified volunteer fire department since January 1, 1981.

The Act also provides that a reasonable amount of land, which is functionally related and subordinate to a firehouse which qualifies for tax-exempt financing, may also be financed with tax-exempt bonds as part of the acquisition or construction of the firehouse.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to bonds issued after November 10, 1988.

STATE REVENUE IMPACT

This special treatment for bond issues of volunteer fire departments has been a nonconformity issue for California since the federal enactment in ERTA 1981 (Economic Recovery Tax Act). If the state were to consider a tax exemption, annual revenue losses would not be significant.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE H: Tax-Exempt Bond Provisions

ACTION: REMOVES SMALL ISSUER QUALIFICATIONS EXCEPTION FOR POOLED FINANCING BONDS

Act Section 6183

BACKGROUND

For federal income tax purposes, interest on state and local government bonds are generally tax-exempt. To qualify for this tax-exempt status, certain arbitrage restrictions must be satisfied with respect to arbitrage earnings. One of the restrictions is that nonpurpose arbitrage earnings must be rebated to the Federal Government. However, special provisions exist for governmental units with general taxing powers where the unit does not issue more than $5 million in bonds during the year, to be exempt from the rebating requirements.

Currently, State or local government may issue bonds and use the proceeds of the issue to finance or make loans to other persons. These type of bonds are known as pooled financing bonds. Regardless of the ultimate user of the funds from pooled financing, the bonds are counted towards the determination of whether the issuer of such bonds qualify as a small issuer.

CURRENT CALIFORNIA LAW

California does not have a provision which relates directly to the tax-exempt treatment of pooled financing bonds. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (Sec. 148(f)(4)(c)(iii)

The Act provides that pooled financing bonds issued by a governmental unit (not an ultimate borrower) on behalf of other governmental units with general taxing power and not subordinate to the issuing unit (ultimate borrowers), are not counted towards the $5 million limit for determining whether the issuer qualifies under the small-issuer exception on its nonpooled financing bonds.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to bonds issued after December 31, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE I: Provisions Relating To Tax Exempt Organizations

ACTION: *MODIFIES SECTION 1834 OF THE TAX REFORM ACT OF 1986 RELATING TO GAMES OF CHANCE*

Act Section 6201

BACKGROUND

Tax-exempt organizations are subject to tax on income derived from an unrelated trade or business. Bingo games are excluded from the term "unrelated trade or business". The Deficit Reduction Act of 1984 (P.L. 98-369) provided that the unrelated business income tax (UBIT) does not apply to income of a tax-exempt organization derived from conducting a game of chance (gambling) in a state having a statute, in effect as of October 5, 1983, providing that only nonprofit organizations may conduct such activities. This provision was applied retroactively to games of chance conducted after June 30, 1981, in taxable years ending after that date.

The only state to which this provision was intended to apply was North Dakota. Accordingly, Section 1834 of the Tax Reform Act of 1986 (P.L. 99-514) clarified this by providing that the state law permitting nonprofit organizations to conduct games of chance must have been originally enacted on April 22, 1977, the date of enactment of North Dakota's law. As a result of this provision, such income derived by exempt organizations in other states was treated as not subject to UBIT under the 1984 Act, but was retroactively treated as taxable under the 1986 Act.

CURRENT CALIFORNIA LAW (Sec. 17631, 17632, 23710, 23731 and 23732)

California has the same rules relating to "unrelated business income", including an exemption for bingo games. All income from unrelated trade or businesses has to be reported on the California return. If it is derived from sources within or without California, an apportionment of income is required. For trusts which have unrelated trade or business income from sources without California, the trust must report the same proportion of the income as the number of resident trustees bears to the total number of trustees. Also, where a part or all of the unrelated trade or business income is taxed by more than one state, California or the other state may allow a tax credit for that portion of the income which is subject to taxation by the other state.

NEW FEDERAL LAW (Act Sec. 6201)

TAMRA amends the 1986 Act by providing that the 1986 amendment to the 1984 Act applies only to games of chance conducted after October 22, 1986, the date of enactment of the Tax Reform Act of 1986, thus nullifying the retroactive treatment (taxation) of income from games of chance in states other than North Dakota.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The treatment of income derived by tax-exempt organizations from games of chance conducted prior to October 22, 1986 are governed by the provision of the 1984 Act as originally enacted; i.e., excluded from UBIT.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE I: Provisions Relating to Tax Exempt Organizations

ACTION: CLARIFIES THE TERM "PURCHASING" BY A HOSPITAL SERVICE ORGANIZATION

Act Section 6202

BACKGROUND

Federal law provides tax-exempt status for hospital service organizations operated solely to perform, on a centralized basis, certain services for two or more tax-exempt hospitals, including hospitals owned and operated by the federal or local government. The services are: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel services.

CURRENT CALIFORNIA LAW (Sec. 23704)

California is in conformity with the federal provision treating a hospital service organization as an exempt organization.

NEW FEDERAL LAW (Sec. 501(e))

The Act clarifies that "purchasing" by a hospital service organization includes the acquisition, on a group basis, of insurance (such as malpractice and general liability insurance) for its hospital members.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision defining purchasing by a tax-exempt hospital service organization to include the acquisition of group insurance for its hospital members applies to such purchases made before, on, or after November 10, 1988.

STATE REVENUE IMPACT

No revenue impact results from this clarification of law pertaining to hospital service organizations.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE I: Provisions Relating To Tax Exempt Organizations

ACTION: MODIFIES THE 85 PERCENT TEST FOR TAX EXEMPT STATUS OF RURAL UTILITIES

Act Section 6203

BACKGROUND

Under federal law, a mutual or cooperative telephone, electric or water company qualifies for exemption from federal income taxation if at least 85 percent of its gross income consists of amounts collected from members for the sole purpose of meeting losses and expenses of providing service to its members. In the case of mutual or cooperative telephone or electric companies, the 85 percent test is determined without regard to income from certain qualified pole rentals. In the case of mutual or cooperative telephone companies, the 85 percent test is determined without regard to income from certain long-distance fees and telephone directory income. Gross income of a taxpayer generally includes income from the discharge of indebtedness.

CURRENT CALIFORNIA LAW (Sec. 17071 and 24271)

California does not have a counterpart to Section 501(c)(12) of the Internal Revenue Code (relating to tax exemption of a mutual or cooperative telephone, electric or water company). However, California does conform to federal law relating to the taxation of income from the discharge of indebtedness.

NEW FEDERAL LAW (Sec. 501(c)(12)(A) and Act Sec. 6203)

This Act, in a noncode provision, states that the 85 percent test is to be determined without regard to any discharge of indebtedness income arising in 1987, 1988, or 1989 on debt that either originated with, or is guaranteed by, the Federal Government.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for loans cancelled after December 31, 1986, and before January 1, 1990.

STATE REVENUE IMPACT

Not applicable. California has not adopted the 85 percent standard for determining the taxability of mutual utilities.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE I: Provisions Relating To Tax Exempt Organizations

ACTION: MODIFIES DEFINITION OF A PRIVATE OPERATING FOUNDATION

Act Section 6204

BACKGROUND

The federal Tax Reform Act of 1969 (P.L. 91-172) added Code Section 4940 (effective for taxable years beginning after December 31, 1969), providing for an annual two percent excise tax on the net investment income of a private foundation. A private foundation is an exempt organization organized exclusively for religious, charitable, or educational purposes which does not receive broad public support.

A further distinction is drawn between a private "operating" foundation and a private "nonoperating" foundation. A private "operating" foundation is defined as one that spends at least 85 percent of its income in the active conduct of its exempt activities and has 65 percent of its assets directly devoted to its exempt purpose.

The Deficit Reduction Act of 1984 (P.L. 98-369) added language providing for an exemption from this excise tax for an operating foundation that is broadly supported by, and governed by representatives of, the general public. This provision was operative for taxable years beginning after December 31, 1984. However, a foundation that was an operating foundation as of January 1, 1983, is treated as meeting the requirements of this provision.

That Act also provided for a reduction in this excise tax to one percent if the corporation satisfies certain requirements as to the level of distributions to charities and was not liable during any base-period year for the tax imposed on undistributed income.

CURRENT CALIFORNIA LAW (Sec. 23708 and 23709)

Although California has conformed in principle to the federal law by creating a special category of charitable organizations classified as "private foundations", California has not adopted many of the complicated federal provisions relating to such organizations. An organization which receives private foundation status for federal purposes is automatically a private foundation under California law.

Whereas federal law imposes an excise tax on the investment income of private foundations and a series of excise taxes on self-dealing, income accumulations, prohibited investments, lobbying, termination, etc., California has never conformed to the imposition of excise taxes on private foundations. In order to limit the impact of these excise taxes, the federal law contains a subcategory of private foundations called private operating foundations. California has no need for this subcategory since it imposes no excise tax on private foundations.

NEW FEDERAL LAW (Act Sec. 6204)

The Act provides that for purposes of the Deficit Reduction Act of 1984, a private foundation that constituted an operating foundation for its last taxable year ending before January 1, 1983 is treated as constituting an operating foundation as of January 1, 1983, and therefore will be exempt from the excise tax on net investment income.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision was effective on November 10, 1988, the date of enactment of TAMRA.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE J: Taxpayer Rights and Procedures

ACTION: PART I - TAXPAYER RIGHTS CODIFIED

Act Sections 6227 through 6235

BACKGROUND AND SUMMARY OF DIFFERENCE

The federal "Taxpayers' Bill of Rights" was first introduced in 1987. During the legislative process it was revised and reintroduced several times but failed passage. In late 1988 the provisions were added to TAMRA as the "Omnibus Taxpayer Bill of Rights".

The preliminary version of California's Taxpayers' Bill of Rights was introduced in January 1988 (AB 2788, Harris-Katz and AB 2833 Katz-Harris). After numerous revisions (with the original version of the federal bill as a basis), the bills became law in September 1988. The provisions of AB 2788 are administered by the Franchise Tax Board (FTB) and the provisions of AB 2833 are administered by the Board of Equalization (BOE).

AB 2788, in general, provided the taxpayer with protection that is equal to that provided by TAMRA, and in some areas, the provisions of AB 2788 extended beyond the federal provisions in order to focus on taxpayer's education or practices that are unique to California because of it's laws and procedures.

The following discussion highlights the differences between the federal provisions that pertain to taxpayer rights and the related California law or current practice. (It is noted that the phrase "the California provision", for purposes of this discussion, means the provision as enacted by AB 2788).

DISCLOSURE OF RIGHTS TO TAXPAYER (R&T Sec. 21007 and TAMRA Sec. 6227)

The California provision is broader in scope than the provision in the federal act, i.e., the IRS must disclose to the taxpayer his or her rights when the taxpayer is contacted during an audit (no amendment to IRC), whereas FTB must disclose to the taxpayer his or her rights with most of its taxpayer notices and also in its tax booklets.

PROCEDURES INVOLVING TAXPAYER INTERVIEWS (R&T Sec. 21011 and TAMRA Sec. 6228)

The California provision is generally the same as the federal provision, in that: (1) the taxpayer may record the interview; (2) in the event the government is to record the interview, the government must give the taxpayer prior notice and the taxpayer is entitled to a copy; and (3) the taxpayer must receive notice of his or her rights prior to the interview.

TAXPAYERS RELIANCE IN ERRONEOUS WRITTEN ADVICE (R&T Sec. 21012 and TAMRA Sec. 6229)

The California provision is broader than the federal provision, i.e., under the federal provisions with certain safeguards, IRS will abate the penalties that are attributable to the taxpayer's reliance on the government's erroneous written advice, whereas, FTB (with additional safeguards) will abate: (1) tax, penalties, additions to tax and interest if attributable to an erroneous chief counsel ruling; or (2) penalties, additions to tax and interest if attributable to erroneous written advice that is other than a chief counsel ruling.

TAXPAYER ASSISTANCE ORDERS (R&T Sec. 21004 and TAMRA Sec. 6230)

The California provision provides the same general concept that is provided by the federal provision, i.e., under federal law the Office of the Ombudsman can require the IRS to cease any action where the taxpayer would suffer a significant hardship, and the California provision created a Taxpayers' Rights Advocate who, among other things, must give highest priority to resolving complaints where the taxpayer would suffer an irreparable loss and stay any FTB actions, when appropriate.

BASIS FOR EMPLOYEE EVALUATION (R&T Sec. 21008 and TAMRA Sec. 6231)

The California provision provides the taxpayer the same general protection as the federal act (no amendment to IRC), i.e., the performance or production goals of the government's employees can not be based on the amount of additional tax assessed or taxes collected and the government must certify, as specified, to its compliance with these provisions.

PROCEDURES RELATING TO TEMPORARY REGULATIONS (TAMRA Sec. 6232)

This federal provision (IRC 7805) is not applicable for California purposes since FTB does not have the authority to issue temporary regulations.

CONTENT OF TAX DUE DEFICIENCY AND OTHER NOTICES (R&T Sec. 18645 and 25762 and TAMRA Sec. 6233)

Except for the law relating to tax that is in jeopardy of being assessed or collected (jeopardy assessments) there is no provision requiring FTB to describe the basis for, and identify the amounts of, tax, penalty or interest when issuing a notice to the taxpayer, as this federal provision does (IRC 7521). Under current practice, FTB does, however, identify the amounts of tax, penalty or interest when issuing its notices to the taxpayer.

INSTALLMENT PAYMENT OF TAX LIABILITY (R&T Sec. 18700 and TAMRA Sec. 6234)

FTB, since 1987, has had the authority to enter into an installment payment agreement, which is the subject of this federal provision (IRC 6159).

ASSISTANT COMMISSIONER FOR TAXPAYER SERVICES (TAMRA Sec. 6235)

There is no California law that is comparable to this federal provision. However, FTB's administrative organization has a Taxpayer Services Bureau Director who is responsible for the same services as those provided by the federal provision (IRC 7802).

EFFECTIVE DATE OF FEDERAL PROVISIONS

Both state and federal law became effective in 1989.

STATE REVENUE IMPACT

Not applicable. California has already legislated in this area of taxpayer rights.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE J: Taxpayer Rights and Procedures

ACTION: PART II - LEVY AND LIEN PROVISIONS CODIFIED

Act Sections 6236 through 6238

BACKGROUND AND SUMMARY OF DIFFERENCE

The federal "Taxpayers' Bill of Rights" was first introduced in 1987. During the legislative process it was revised and reintroduced several times but failed passage. In late 1988 the provisions were added to TAMRA as the "Omnibus Taxpayer Bill of Rights".

The preliminary version of California's Taxpayers' Bill of Rights was introduced in January 1988 (AB 2788, Harris-Katz and AB 2833 Katz-Harris). After numerous revisions (with the original version of the federal bill as a basis), the bills became law in September 1988. The provisions of AB 2788 are administered by the Franchise Tax Board (FTB) and the provisions of AB 2833 are administered by the Board of Equalization (BOE).

AB 2788, in general, provides the taxpayer with protection that is equal to that provided by TAMRA and in some areas, the provisions of AB 2788 extended beyond the federal provisions in order to focus on taxpayer's education or practices that are unique to California because of its laws and procedures.

The following discussion highlights the differences between the federal levy and lien provisions and the related California law or current practice. It is noted that for purposes of this discussion:

1. under California law, FTB has less authority with respect to the seizing and selling of taxpayers' property and the garnishment of wages than the IRS under the IRC, i.e., the IRS itself can seize the property of the taxpayer, take title to the property, and conduct the sale. In addition, the FTB is generally not bound by the federal restrictions on wage garnishments. However, under California law, title to the property does not pass to the party taking the action and the seizure and sale of the property is conducted by a law enforcement officer pursuant to the Code of Civil Procedure (CCP). (The CCP is also used in California for enforcing judicial judgements.) In the case of a wage garnishment, FTB again abides by the CCP's exemptions, which are the federal restrictions on wage garnishments (Title 15 U.S.C. 1673 (a));

2. FTB cannot, in general, seize any funds under the control of or held by the federal government, unless a federal provision expressly allows for a state levy (the doctrine of federal sovereignty); and

3. the phrase "the California provision", means the provision as enacted by the Taxpayers' Bill of Rights (AB 2788).

NOTICE RELATING TO LEVY (TAMRA Sec. 6236)

Even though the FTB is not required by statute to send a taxpayer notice 30 days before levy, as is the IRS under this federal provision (IRC 6331 (d)), taxpayers are provided reasonable notice of their rights under current California practice and law, i.e., prior to levy, FTB, administratively, provides the taxpayer with several notices that contain a statement to the effect that his/her failure to pay the debt may result in a levy and these notices must contain information relating to the taxpayer's appeal rights, etc. (R&TC 21007), which is also required under this federal provision. In addition: (1) the levying officer pursuant to the CCP (CCP 688.010, et seq.) must provide notice of levy, which includes information as to the taxpayer's rights and duties; and (2) the FTB must give the taxpayer notice as to its intent to sell his or her property and provide an oral hearing as to why the sale should not take place, if so requested (Dupuy v. Superior Court of Los Angeles, 15 C3d 410). This FTB notice is issued at least 20 days prior to the sale.

CONTINUING LEVY ON SALARY (TAMRA Sec. 6236)

This federal provision (IRC 6331(e)), which allows for a release of levy on salary for circumstances other than payment in full or an unenforceable debt, is not applicable to FTB since there is no California law that limits the release of such levy.

INCREASE IN EXEMPTION AMOUNTS OF CERTAIN PROPERTY (TAMRA Sec. 6236)

With respect to exemptions from levy, there are three areas which are affected by this federal provision. The differences between the state and federal law in these areas are as follows:

1. For furniture and personal effects, books and tools of a trade, and wages and salary, the amounts of the exemptions from levy under the CCP (CCP 704.020, 740.060, and 706.050, respectively) are already greater than the increased amounts provided under these federal provisions (IRC 6334 (a) and (d)).

2. Funds that are exempt from levy by this federal provision (IRC 6334 (a)), i.e., public assistance or Job Training Partnership Act funds are already exempt from levy for state purposes because they are federal funds.

3. Under current policy and the CCP (CCP 704.750), a principal residence is exempt from levy unless approved for sale, as is required by this federal provision (IRC 6334 (e)). It is noted that for California purposes approval for sale must be given at a higher level than under the federal provision, i.e., for California purposes, a judicial action is brought by the Attorney General on behalf of FTB, and only an administrative approval is required by this federal provision.

UNECONOMICAL LEVY(TAMRA Sec. 6236)

This provision (IRC 6236(d)) is not applicable for FTB's purposes, since the FTB, in general, does not incur any expenses of the sale, i.e. the expenses for such sales are paid by the taxpayer (R&TC 18908, et. seq.).

SURRENDER OF BANK ACCOUNT (R&T Sec. 18817 and TAMRA Sec. 6237)

California has a provision similar to this federal provision, i.e., under California law, a bank account must be surrendered after 14 days (10 business days) of receipt of the levy as compared to the 21 days required under this federal provision (IRC 6236 (e)).

RELEASE OF LEVY (R&T Sec. 21016 and TAMRA Sec. 6237)

The California provision requires the release of a levy under circumstances similar to those outlined in the federal provision (IRC 6343).

RIGHT TO REQUEST THAT SEIZED PROPERTY BE SOLD WITHIN 60 DAYS (TAMRA Sec. 6237)

Under California's current law and practice, the taxpayer can achieve the same results as provided by the federal provision (IRC 6335); i.e., the property could be sold within approximately 60 days, if the taxpayer requests the sale.

REVIEW OF LEVY THAT IS MADE LESS THAN 30 DAYS AFTER NOTICE (JEOPARDY LEVY AND ASSESSMENT PROCEDURE) (R&T Sec. 18641 and 25761 and TAMRA Sec. 6237)

The procedure provided by this federal provision is already followed for California purposes. In 1987 California conformed, in general, to the federal jeopardy assessment procedures, to which this "jeopardy levy" provision (IRC 7429) was added, i.e., when FTB makes an immediate levy on a taxpayer, it is the result of a jeopardy assessment and upon protest, the taxpayer will receive an immediate review of the circumstances, which is the purpose of this federal provision.

ADMINISTRATIVE APPEAL OF LIENS (R&T Sec. 21019 and TAMRA Sec. 6238)

In general, the difference between the California provision and the federal provision (IRC 6326) is, that for state purposes the taxpayer has at least 30 days <u>before</u> the filing of a lien to appeal the filing, and any releases must be made within 7 business days (or immediately in certain cases), whereas under the federal provision, the appeal period which will be established by regulations, will begin <u>after</u> the lien has been filed, and any releases must be made within 14 days.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Both state and federal law became effective in 1989.

STATE REVENUE IMPACT

Not applicable. California has enacted its own extensive levy and lien provisions.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE J: Taxpayer Rights and Procedures

ACTION: PART III - PROCEEDINGS BY TAXPAYERS

Act Sections 6239 through 6242

BACKGROUND AND SUMMARY OF DIFFERENCE

The federal "Taxpayers' Bill of Rights" was first introduced in 1987. During the legislative process it was revised and reintroduced several times but failed passage. In late 1988 the provisions were added to TAMRA as the "Omnibus Taxpayer Bill of Rights".

The preliminary version of California's Taxpayers' Bill of Rights was introduced in January 1988 (AB 2788, Harris-Katz and AB 2833 Katz-Harris). After numerous revisions (with the original version of the federal bill as a basis), the bills became law in September 1988. The provisions of AB 2788 are administered by the Franchise Tax Board (FTB) and the provisions of AB 2833 are administered by the Board of Equalization (BOE).

AB 2788, in general, provides the taxpayer with protection that is equal to that provided by TAMRA and in some areas, the provisions of AB 2788 extended beyond the federal provisions in order to focus on taxpayer education or practices unique to California because of it's laws and procedures.

The following discussion focuses on the differences between the federal taxpayer proceedings provisions and the related California law or current practice. It is noted that for purposes of this discussion, the phrase "the California provision", means the provision as enacted by the Taxpayers' Bill of Rights (AB 2788).

AWARDING OF COSTS AND CERTAIN FEES (R&T Sec.21013 and TAMRA Sec. 6239)

It is noted that under California law, a taxpayer's protest is heard by the FTB and appeals against the FTB's action are brought before the BOE in an administrative proceeding, whereas, for federal purposes, the IRS hears the protest and appeals are heard in the U.S. Tax Court, which is a judicial proceeding.

The California provision conforms in part to the federal provision (IRC 7430), in that certain costs and fees may be awarded to taxpayers who prevail in administrative proceedings and demonstrate that the taxing agency was unreasonable in its action. However, for California purposes, the award applies to an administrative proceeding before the BOE, whereas under the federal provision the awards are extended to any administrative proceeding and judicial proceeding with the IRS.

CIVIL ACTIONS FOR DAMAGES (R&T Sec.21021 and TAMRA Sec. 6240)

The California provision is similar to that of the federal provisions (IRC 7432 and 7433) in that: (1) if a officer or employee of the taxing agency causes the taxpayer to sustain damages under certain circumstances, the taxpayer may bring a civil action against the government for those damages and (2) in the event the court finds the civil action brought by the taxpayer to be frivolous, a penalty of up to $10,000 may be imposed by the court (IRC 6673). However, for California purposes, the damages must be caused by the reckless disregard of published procedures whereas, for federal purposes, the damages can be caused by the reckless or intentional disregard of the law or regulations (IRC 7433) or by the knowing or negligent failure to release a lien (IRC 7432).

PENALTY FOR IMPROPER DISCLOSURE BY PREPARERS OF RETURNS (TAMRA Section 6242)

California does not have specified penalties for tax preparers who improperly disclose or use information furnished to him or her in connection with the preparation of a tax return as does the IRC under Sections 6712 and 7216. For federal purposes, any tax return preparer who discloses information furnished for or in connection with the preparation of a tax return will pay a penalty of $250 for each disclosure.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The federal provisions are effective after November 10, 1988, except for the provision that provides for damages caused by the failure to release a lien, which is effective January 1, 1989. The California provision is effective January 1, 1989.

STATE REVENUE IMPACT

Not applicable. California has enacted its own "Taxpayer Bill of Rights" provisions.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE J: Taxpayer Rights and Procedures

ACTION: Part IV - TAX COURT JURISDICTION

Act Sections 6243 through 6247

BACKGROUND AND SUMMARY OF DIFFERENCE

The federal "Taxpayers' Bill of Rights" was first introduced in 1987. During the legislative process it was revised and reintroduced several times but failed passage. In late 1988 the provisions were added to TAMRA as the "Omnibus Taxpayer Bill of Rights".

The preliminary version of California's Taxpayers' Bill of Rights was introduced in January 1988 (AB 2788, Harris-Katz and AB 2833 Katz-Harris). After numerous revisions (with the original version of the federal bill as a basis), the bills became law in September 1988. The provisions of AB 2788 are administered by the Franchise Tax Board (FTB) and the provisions of AB 2833 are administered by the Board of Equalization (BOE). AB 2788, in general, provides the taxpayer with protection that is equal to that provided by TAMRA.

However, with respect to this part of the Taxpayers' Bill of Rights, there are no comparable California provisions because under California law a taxpayer's appeal of an FTB action is heard in an administrative proceeding before the BOE and not a Tax Court which is the judicial proceeding for hearing such appeals under the IRC.

The five provisions added under this part provide the Tax Court with broader jurisdictional authority and are not applicable to the laws administered by the FTB.

EFFECTIVE DATE OF FEDERAL PROVISIONS

These federal Tax Court provisions are effective after November 10, 1988.

STATE REVENUE IMPACT

Not applicable to California's current system of administrative/ judicial proceedings.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE K: Other Administrative Provisions

ACTION: MODIFIES THE POPULATION REQUIREMENT FOR ELIGIBILITY FOR DISCLOSURE OF RETURN INFORMATION

Act Section 6251

BACKGROUND

Due to confidentiality and disclosure rules adopted by Congress, the exchange of tax information between federal and state governments is closely guarded. The federal government has established procedures and safeguards to protect individual taxpayers from unauthorized disclosure. The conditions under which returns and return information can be disclosed are specifically enumerated in the federal law. Disclosure of returns and return information to local governments is not generally permitted. However, a specific exception to this rule provides that any city with a population in excess of 2 million that imposes an income (or wage) tax may, if the Secretary enters into an agreement with the city, receive returns and return information for the same purposes for which States may obtain information and subject to the same safeguards as apply to States.

CURRENT CALIFORNIA LAW

California has no provision relating to the disclosure of return information to cities. However, the California Franchise Tax Board is required by the provisions of the Information Practices Act of 1977 and the federal Privacy Act to comply with provisions of those federal laws to protect the individual taxpayers. Except in specified cases, it is a misdemeanor for any member of the Board, any officer of the state, or any other individual to disclose information contained in a tax or information return or report. In these regards, the Board is authorized by law to furnish information shown on the return to the following under certain circumstances:

1. Judicial or administrative proceeding pertaining to tax administration,

2. Legislative committee request,

3. Attorney General or other legal representative of the state,

4. U.S. Commissioner of Internal Revenue or his representative,

5. Tax officials of California or other states,

6. Members of the Multistate Tax Commission,

7. Director of Social Services or his deputies of record, and

8. State Controller.

NEW FEDERAL LAW (Sec. 6103(b)(5)(B)(i))

The new provision modifies the federal law by reducing a city's population requirement for eligibility to receive confidential tax returns and return information. Cities that qualify must now have populations in excess of 250,000 and impose a tax on income or wages.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision became effective on November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE K: Other Administrative Provisions

ACTION: REPEAL OF SECRETARIAL AUTHORITY TO PRESCRIBE CLASS LIVES

Act Section 6253

BACKGROUND

Pre-1988 federal law placed the responsibility of evaluating and establishing class lives of all depreciable assets with the Secretary of the Treasury.

CURRENT CALIFORNIA LAW (Sec. 17201 and 24349)

Current California law generally adopts the federal asset depreciation range system which establishes class lives for property.

NEW FEDERAL LAW

The authority for the Secretary of the Treasury to evaluate and establish class lives is repealed. This repeal of authority also extends to assets which do not have class lives. However the Secretary would continue to be responsible for studying the actual experience of depreciable assets and reporting the findings to Congress.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective beginning November 10, 1988.

STATE REVENUE IMPACT

No identifiable revenue impact.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE K: Other Administrative Provisions

ACTION: REPEALS REPORTING REQUIREMENTS FOR WINDFALL PROFIT TAX

Act Section 6254

BACKGROUND

The federally imposed crude oil windfall profit tax was repealed for oil removed on or after August 23, 1988 (P.L. 100-418). On October 11, 1988, the Internal Revenue Service issued Notice 88-115 providing that the annual information return of windfall profit tax is waived with respect to crude oil removed (or deemed removed) on or after January 1, 1988, if certain conditions are met.

CURRENT CALIFORNIA LAW

California does not impose an excise tax on the windfall profits of domestically produced crude oil.

NEW FEDERAL LAW (Sec. 4997)

The Act repeals the reporting requirements with respect to crude oil removed on or after December 31, 1987 if (1) the person otherwise required to furnish or file an information return for calendar year 1988 must reasonably believe that no windfall profit tax accrued during 1988 with respect to such crude oil, and (2) there was no windfall profit tax withholding with respect to such crude oil.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The repeal of the reporting requirements with respect to crude oil is effective only for crude oil removed after December 31, 1987, for which no tax is due or withheld under former Chapter 45 of subtitle D of the Internal Revenue Code of 1986.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE L: Provisions Relating to Corporations and Personal Holding Companies

ACTION: AUTHORITY TO PAY REFUNDS TO STATUTORY OR COURT-APPOINTED FIDUCIARY OF INSOLVENT MEMBER OF AFFILIATED GROUP

Act Section 6276

BACKGROUND

Under pre-1988 federal law the common parent of an affiliated group filing a consolidated return is the agent of all members of the group in matters before the Internal Revenue Service. This common parent agency provision generally requires a refund attributable to losses of any member to be paid by the Internal Revenue Service to the parent corporation.

If a subsidiary of an affiliated group (group of subsidiaries with a parent corporation) becomes insolvent and becomes subject to a statutory or court-appointed receivership or other similar fiduciary relationship, the fiduciary may have difficulty obtaining access to tax refunds attributable to that member's losses, due to the operation of the common parent agency provision.

CURRENT CALIFORNIA LAW (Sec. 19051, 25902 and 26701)

In the case of a subsidiary who files a combined report with the parent corporation and the parent corporation makes the payments, any refund resulting from the report is paid to the parent corporation. This occurs even if the refund is due directly to the losses of the subsidiary. However, if the subsidiaries make separate payments to the Franchise Tax Board and are included in the combined report, then the Board would pay to the subsidiary the refund amount attributable to that subsidiary.

In addition, the Franchise Tax Board has the authority to offset a taxpayer's (individual or corporation) refund against liabilities relating to other income or taxable years (not including years that are closed by the statute of limitations).

NEW FEDERAL LAW (Sec. 6402)

The Secretary of the Treasury is authorized to provide access to tax refunds to a statutory or court appointed fiduciary of an insolvent member of a group of corporations filing a consolidated tax return, to the extent the Secretary determines: (1) that the refund is properly attributable to the losses of such insolvent member; and (2) that such access is consistent with the purposes of the consolidated return provisions. It is also intended that the Secretary may authorize participation by such fiduciary in the controversy and refund procedure.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for pending or future statutory or court appointed fiduciary situations, in accordance with any regulations promulgated under the Treasury Department's regulatory authority.

STATE REVENUE IMPACT

Unknown but minor. The feasibility of a similar authorization by the Franchise Tax Board extended to unitary members of a combined report (which may not correspond to entities of a federal consolidated return) will require further study.

TITLE VI: Other Substantive Revenue Provisions

ACTION: APPLICATION OF NET OPERATING LOSS LIMITATIONS TO BANKRUPTCY REORGANIZATIONS

Act Section 6277

BACKGROUND

Under the 1986 Tax Reform Act (TRA 86), the net operating loss of a corporation which has had an ownership change, in general, may be limited as to the amount of the NOL deduction that can be taken on the "successor" corporation's return. In the case of ownership changes resulting from bankruptcy proceedings, the general limitations are not applicable as there are special limitations and rules for determining ownership changes. To test whether an ownership change has occurred, in general, the percentage points of stock ownership at the time of a change is compared to the stock ownership of those having more than 5 percent ownership prior to the change. The TRA 86 limitations are generally effective for ownership changes occurring after January 1, 1987, so any change that occurred after that time would be taken into consideration when determining whether an ownership change has occurred for purposes of applying the limitations. However in the case of bankruptcy reorganizations, if the ownership change results from bankruptcy petitions filed with the court before August 14, 1986, the TRA 86 limitations and rules do not apply. However, proposed regulations provide that in the case of those bankruptcy reorganizations that result from bankruptcy petitions filed with the court before August 14, 1986, any shift in ownership after December 31, 1986 arising out of that reorganization shall not be taken into account for purposes of determining whether a change occurred.

CURRENT CALIFORNIA LAW (Sec. 24592)

California conforms to TRA 86's limitations on NOLs. However, it did not conform to the federal effective date transition rules.

NEW FEDERAL LAW (noncode provision)

Under TAMRA, corporations with bankruptcy petitions filed before August 14, 1986 (1) can elect to be subject to the TRA 86 rules for purposes of applying the NOL limitation rules, and (2) who do not make such election, will not make the determination as to whether there was a change of ownership resulting from the bankruptcy reorganization until the final settlement.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective as though enacted by the TRA 86.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE L: Provisions Relating to Corporations and Personal Holding Companies

ACTION: APPLICATION OF SEC. 7503 TO REVISIONS MADE TO SEC. 1503 BY THE REVENUE ACT OF 1987

Act Section 6278

BACKGROUND

Current federal law (after the 1987 Revenue Act) relating to consolidated returns provides that for purposes of dispositions of a subsidiary's stock, the parent's basis in the stock of a subsidiary with which it files a consolidated return will be determined by computing the earnings and profits of the subsidiary without taking into account certain special adjustments. This federal provision was effective for dispositions after December 15, 1987. An exception to this effective date applied to dispositions occurring before January 1, 1989 under a written binding contract or other instrument executed before December 16, 1987.

It was unclear how IRC Section 7503 impacted the above exception. Section 7503 provides that when the last day prescribed under authority of the Internal Revenue Laws for performing any act falls on Saturday, Sunday or a legal holiday, the performance of such act shall be considered timely if it is performed on the next succeeding day which is not a Saturday, Sunday or a legal holiday.

Since December 31, 1988 fell on a Saturday, it was unclear whether the stock of the subsidiary could be disposed of on the following Tuesday and still fall within the above exception. (Sec 1503)

CURRENT CALIFORNIA LAW

California has not conformed to the federal rules for consolidated returns nor to the changes made in these rules made by the 1987 Revenue Act.

NEW FEDERAL LAW (noncode provision)

The new federal provision provides that Section 7503 applies to the above exception to Section 1503.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This section applies to dispositions made before January 4, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE L: Provisions Relating to Corporations and Personal Holding Companies

ACTION: EXCLUDE FROM PERSONAL HOLDING COMPANY INCOME INTEREST EARNED BY BROKER/DEALER

Act Section 6279(a)

BACKGROUND

The personal holding company sections were originally enacted to stop an abuse. Individual taxpayers (in high brackets) were transferring passive investments (stocks, bonds, etc.) to corporations they formed so that income from these investments would be taxed at the lower corporation tax rate.

To stop the abuse, Congress enacted the personal holding company provisions. These sections impose a personal holding company tax on undistributed personal holding company income of corporations found to be personal holding companies.

A corporation is a personal holding company if at least 60 percent of its adjusted gross income is personal holding company income and less than 6 shareholders own more than 50 percent of the value of its outstanding stock.

Personal holding company income consist of dividends, interest, royalties, annuities and rents.

There are some exceptions to the above definitions.

CURRENT CALIFORNIA LAW

California has not conformed to the imposition of a personal holding company tax since the abusive situation will not occur under the rate structure of the California Bank and Corporation tax.

NEW FEDERAL LAW (Sec. 543(a)(1))

Personal holding company income excludes interest received by securities broker/dealers with respect to:

1. any securities or money market investments held as inventory,
2. margin accounts, or
3. any financing for a customer secured by securities or money market instruments.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The amendment is effective November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE L: Provisions Relating to Corporations and Personal Holding Companies

ACTION: EXCLUDES UP TO $3,000,000 PER YEAR OF DIVIDENDS RECEIVED FROM A BANK FROM THE PERSONAL HOLDING COMPANY INCOME OF A "QUALIFIED" BANK HOLDING COMPANY UNDER CERTAIN CONDITIONS

Act Section 6280

BACKGROUND

Under prior federal law, a corporation that is treated as a personal holding company is subject to a 28 percent tax on undistributed personal holding company income (PHCI), which is in addition to the regular tax on corporations.

PHCI generally includes passive income, but does not include income such as rents and royalties that produce most of the corporation's income if the corporation has only limited amounts of PHCI, and incurs deductible expenses evidencing an active business activity (not a mere collection of passive income).

Certain corporations, including banks, are excepted from the definition of a personal holding company.

In a 1971 ruling, the IRS held that PHCI of a bank holding company does not include dividends paid by the subsidiary bank where the bank holding company owns 80 percent or more of the bank's stock.

It was felt that such bank holding companies (as defined in the Act) are actively engaged in the control and operation of banks, so dividends they receive from such banks should be treated as active income.

CURRENT CALIFORNIA LAW (Sec. 23102)

IRS code section applicable to personal holding companies provide a penalty tax on corporations holding substantial amounts in investment portfolios where the interest and dividend income was not passed through to high bracket taxpayers.

California, with a corporate tax rate which is the same as the top personal income tax rate, has not adopted similar provisions.

The California Bank and Corporation Tax Law does provide that any corporation holding stocks or bonds of any other corporation and not trading in stocks or bonds or other securities held and engaging in no activities other than the receipt and disbursement of dividends from the stocks or interest for the bonds is not considered to be a corporation doing business in the state for purposes of the California franchise tax. However, the dividends and interest the holding company received would be taxable under the California Income Tax provisions.

NEW FEDERAL LAW (noncode provision)

Under the new provision, up to $3,000,000 per year of dividends received from a bank is excluded from the PHCI of a "qualified" bank holding company if:

1. the bank holding company owns at least 25 percent (by value and vote) of the bank's stock, and

2. 80 percent or more of the total value of the assets of the bank holding company consist of stock in one or more of 25 percent-owned banks during the entire year.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for dividends received by a bank holding company during any taxable year ending in 1989 or 1990.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE L: Provisions Relating To Corporations And Personal Holding Companies

ACTION: AUTHORIZES THE ISSUANCE OF REGULATIONS THAT ALLOW CORPORATIONS (OTHER THAN S CORPORATIONS) TO PROVIDE LESS-DETAILED SUBSTANTIATION FOR CONTRIBUTIONS OF INVENTORY PROPERTY

Act Section 6281

BACKGROUND

Under the Tax Reform Act of 1984 (P.L. 98-369), individuals, closely held corporations, and personal service corporations generally must obtain qualified appraisals meeting specified requirements in order to claim a charitable deduction exceeding $5,000 for certain contributions of property. (In the case of S corporations, the qualified appraisal requirements apply where the corporation claims such a charitable deduction.) An IRS announcement (IRB 88-137) provides that less stringent appraisal requirements would apply to charitable donations by certain corporations of inventory property to be used for care of the ill, the needy, or infants, such as contributions of food by a food retailer (if a C corporation) to tax-exempt organizations aiding the homeless.

CURRENT CALIFORNIA LAW (Secs. 24357 - 24359)

California corporate law generally conforms to federal law relating to the deduction for charitable contributions with the following pertinent differences:

1. California limitation is 5% of net income: Federal 10%.

2. There are differences in the adjustments to income for purposes of computing the limitation, i.e., for federal purposes, income is adjusted for operating loss carryovers and other special deductions not applicable to California.

3. Federal law provides for a 5-year carryover of contributions in excess of the limitation; California has no carryover.

4. The federal law was amended in 1984 to provide special rules for certain noncash contributions, contributions of conservation interests, and contributions to private foundations; California conformed in 1985 regarding conservation interests, but has not conformed to the other 1984 federal amendments.

NEW FEDERAL LAW (Act Sec. 6281)

This Act, in a noncode provision, authorizes the Treasury Department to prescribe regulations allowing corporations (other than S corporations) to provide, in the case of charitable contributions of inventory property, less detailed substantiation than that required under the present-law qualified appraisal rule. For example, the regulations could require the donor corporation to furnish summary information about the donated inventory with its tax return, such as a description of the contributed items and the valuation method used. This provision authorizes waiver only of the 1984 Act qualified appraisal requirement, and does not modify the general statutory rule that a charitable contribution is deductible only if verified in the manner required by Treasury regulations.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective on November 10, 1988.

STATE REVENUE IMPACT

None.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE L: Provisions Relating to Corporations and Personal Holding Companies

ACTION: RELIEF FROM RECOGNITION OF CORPORATE LEVEL GAIN INVOLVING TRANSFER OF RESIDENTIAL COOPERATIVE UNITS

Act Section 6282

BACKGROUND

When a corporation distributes appreciated property to its shareholders in a liquidating or nonliquidating distribution, it generally recognizes gain. The shareholders who receive appreciated property in such a distribution in exchange for their stock generally recognize gain to the extent that the value of the property distributed exceeds their bases in the corporation's stock.

However, federal law allows taxpayers, including tenant-stockholders in cooperatives, to defer the gain if the taxpayer realizes gain on the sale of his principal residence and acquires another principal residence within a two-year period.

CURRENT CALIFORNIA LAW (Sec. 24382)

California is in conformity with federal law.

NEW FEDERAL LAW (Sec. 216(e))

Under the new provision, gain or loss will not be recognized by a residential housing cooperative when property qualifying as a principal residence is distributed to the tenant-shareholder in exchange for stock. This rule applies only to the extent that the shareholder is not required to recognize gain under Section 1034.

The Treasury Department is expected to issue regulations with reporting and other procedures, so that the relief only applies when the taxpayer-stockholder uses the house or apartment as a principal residence both before and after the exchange.

The Treasury Department may also issue regulations providing for recapture of tax benefits by the cooperative, to the extent the shareholder could not have claimed the same benefits by owning the unit directly and using it as a principal residence.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is generally effective for liquidating distributions made after July 31, 1986, and nonliquidating distributions made after December 31, 1986.

STATE REVENUE IMPACT

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue losses would be minor, in the $250,000 range annually.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE M: Miscellaneous Provisions

ACTION: REPEALS STATUTORY LIMITATION ON LONG TERM TREASURY BONDS

Act Section 6301

BACKGROUND

In 1918 a provision was enacted to provide that the rate of interest that may be paid on a United States bond--defined as an obligation with more than 10 years to maturity when issued--may not exceed 4 1/4 percent. The first exception was enacted in 1971 to provide relief from rapid shortening average maturity of outstanding debt during a period of several years when interest rates were rising.

When the exception was enacted in 1971, the limitation was set at $10 billion, which applies to all bonds issued with rates of interest above 4 1/4 percent. Two years later in 1973, the exception was amended to apply only to bonds held by the general public. Bonds held by Federal Agencies and the Federal Reserve Banks were not included in the amount subject to the exception.

The Omnibus Reconciliation Act of 1987 enacted the last prior increase in the exception to allow the Secretary of Treasury to issue up to $270 billion in bonds with interest rates above the 4 1/4 percent statutory limit.

Several decades have passed since the Secretary has been able to issue bonds with an interest rate at or below 4 1/4 percent. Therefore Congress repealed the statutory limitation on the interest rate which has been obsolete for many years.

CURRENT CALIFORNIA LAW

California does not have a provision which relates to statutory limitations on long term United States bonds. Federal law provides a number of complex restrictions on the exclusion of state and municipal bond interest. California does not incorporate these federal sections. Instead, California excludes from gross income interest earned on obligations issued by California or local governments within California, by the United States, or by territories of the United States.

NEW FEDERAL LAW (noncode provision)

The Act repeals the statutory limitation (currently $270 billion) on the total amount of obligations which may be issued which mature more than 10 years from the date of issue with interest rates above 4 1/4 percent.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to bonds issued on or after November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE M: Miscellaneous Provisions

ACTION: EXTENDS FOR ONE YEAR THE CREDIT FOR PRODUCING FUEL FROM A NONCONVENTIONAL SOURCE

Act Section 6302

BACKGROUND

The Internal Revenue Code provides a tax credit for the production of qualified nonconventional fuels. Such fuels include oil or natural gas produced from unusual geological formations and synthetic fuels derived from coal (including lignite). The production credit is available generally to qualified fuels which are produced in a facility placed in service after December 31, 1979, and before January 1, 1990, and which are sold after December 31, 1979, and before January 1, 2001.

CURRENT CALIFORNIA LAW (None)

California does not allow a tax credit for the production of fuels from nonconventional sources.

NEW FEDERAL LAW (Sec. 29(f)(1)(A))

This Act amends federal law by providing that qualified fuels are eligible for the production credit if they are produced from a facility placed in service or a well drilled before January 1, 1991. This is one year later than the previous expiration date of January 1, 1990 for this credit. The extension was granted because facilities may not have been placed in service by December 31, 1989 for reasons which the taxpayer had no control, such as acts of God or changes in legislation governing regulatory procedures or environmental regulations.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective on November 10, 1988.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE M: Miscellaneous Provisions

ACTION: CERTAIN DISCHARGE OF DEBT INCOME NOT INCLUDED IN ADJUSTED BOOK INCOME

Act Section 6303

BACKGROUND

If a discharge occurs in a Title 11 bankruptcy case or when the taxpayer is insolvent, a corporation's gross taxable income does not include any amount that results from a discharge of indebtedness. The exclusion from gross income for an insolvent taxpayer is limited to the amount of its insolvency. This exclusion applies to a corporation that exchanges its stock for its debt.

A corporation in Title 11 bankruptcy proceedings or insolvency can have book income, calculated under generally acceptable accounting principles, in the amount of the excess of the debt's principle amount over the fair market value of the stock issued in exchange for such debt. This adjustment to book income can result in an alternative minimum tax liability for tax years beginning in 1987, 1988, and 1989 when alternative minimum taxable income is increased by one-half of the excess of pre-tax book income over other alternative minimum taxable income.

In order to ensure that a discharge of indebtedness by a corporation that is in Title 11 bankruptcy or is insolvent does not result in either regular or alternative minimum tax liability, a new provision was enacted to provide that the transfer by a corporation of its own stock in exchange for its debt does not result in book income.

CURRENT CALIFORNIA LAW (Sec. 23400)

For income years beginning after 1987, California imposes an alternative minimum tax on corporations in substantial conformity to the federal alternative minimum tax enacted by the 1986 Tax Reform Act. The California alternative minimum tax replaces the tax on preference items, which applies to income years beginning before 1988.

Federal law, as incorporated by California, requires alternative minimum taxable income for income years 1988 and 1989 be increased by 50 percent of any amount by which the net book income, as adjusted and modified for state purposes, excees alternative minimum taxable income of a corporation.

NEW FEDERAL LAW (Sec. 56(f)(2)(I))

Under the new provision, the transfer of a corporation's own stock in exchange for the corporation's debt in a Title 11 bankruptcy case does not give rise to adjusted net book income. In the case where the corporation is insolvent, the exclusion from book income is limited to the amount of its insolvency.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for taxable years beginning after December 31, 1986.

STATE REVENUE IMPACT

Based on the low level of revenue losses estimated for the nation by the Joint Committee on Taxation, comparable state revenue losses would be negligible.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE M: Miscellaneous Provisions

ACTION: ALLOWS THE NONCONVENTIONAL FUEL CREDIT DISALLOWED BECAUSE OF THE TENTATIVE MINIMUM TAX LIMITATION TO INCREASE THE CREDIT FOR PRIOR YEAR MINIMUM TAX CREDIT

Act Section 6304

BACKGROUND

Currently, the nonconventional fuel credit can be used only to the extent regular tax exceeds the taxpayer's tentative minimum tax after regular tax has been reduced by the foreign tax credit. This credit does not contain carryover provisions.

Also, when a taxpayer pays alternative minimum tax, the amount of the net minimum tax generally is allowed as a credit against regular tax liability of the taxpayer in later years.

CURRENT CALIFORNIA LAW

California has no provision allowing a nonconventional fuel credit.

NEW FEDERAL LAW (Sec. 53(d)(1)(B)(iii))

Under the new provision, the nonconventional fuel credit, not allowed for the taxable year because of the tentative minimum tax limitation, will increase the taxpayer's credit for prior year minimum tax.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for tax years beginning after December 31, 1986.

STATE REVENUE IMPACT

Not applicable.

TITLE VI: Other Substantive Revenue Provisions

SUBTITLE M: Miscellaneous Provisions

ACTION: ELIMINATE EMPLOYMENT TAXES FOR QUALIFIED SERVICE PROVIDERS

Act Section 6305

BACKGROUND

Under federal tax law provisions, the determination of whether an employer-employee relationship exists is made under the common law test. This test indicates that an employer-employee relationship exists if the person contracting for services has the right to control the result of the services as well as the means by which they are accomplished.

CURRENT CALIFORNIA LAW (U.I. Code 621)

California law defines "employee" as any officer of a corporation and any individual who under the usual common law rules applicable in determining the employer-employee relationship has the status of an employee. In addition, Section 621 of the California Unemployment Insurance Code also provides exceptions where under common law rules an individual would be considered an independent contractor.

NEW FEDERAL LAW (Act Sec. 6305)

This Act section (an uncodified provision) provides that the federal government, any state or political subdivision, the District of Columbia, or any agency or intrumentality of the foregoing can treat a person who renders dependent care or similar services as other than an employee for employment tax purposes if the following conditions are met:

1. The person does not provide any dependent care or similar services in any facility owned or operated by a governmental agency;

2. The person is compensated by a governmental agency for services out of funds provided under the Social Security Code or by the Family Support Act of 1988;

3. The governmental agency does not treat the person as an employee for employment tax purposes;

4. The governmental agency files all federal tax returns in a manner consistent with the person's status as not being an employee;

5. No more than 10 percent of the governmental agency's employees may be provided with insurance under Title II of the Social Security Act.

Also, the provision requires the Secretary of the Treasury to report to Congress on the tax status of day care providers compensated under the programs, as described above, by December 31, 1989.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to the period January 1, 1984 through December 31, 1990.

STATE REVENUE IMPACT

Negligible cash flow revenue impact for California.

PART III

OTHER 1988 FEDERAL LEGISLATION

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OTHER 1988 FEDERAL LEGISLATION

I. Orphan Drug Amendments
(P.L. 100-290, Signed April 8, 1988)

This Act requires the Secretary of Health and Human Services to conduct a study to determine whether there is still need to encourage the development of medical devices and medical foods for rare diseases and/or conditions through provisions in the Federal Food, Drug, and Cosmetic Act and through the orphan drug tax credit. The report on this study is to be sent to Congress by April 8, 1989.

California has enacted an Orphan Drug Credit (which will expire at the end of 1992) patterned after the federal credit but applicable only for testing conducted in California and the credit percentage is 15 percent.

II. Medicare Catastrophic Coverage Act
(P.L. 100-360, Signed July 1, 1988)

This Act imposes, under the Internal Revenue Code, an addition to tax liability for a supplemental medicare premium starting in 1989. Estimated tax will be required on this new tax starting in 1990. In addition, this Act requires that the Secretary of the Treasury conduct a study of federal tax policies to promote the private financing of long-term care with a due date to Congress of November 30, 1988.

III. Wartime Relocation of Civilians
(P.L. 100-383, Signed August 10, 1988)

This Act provides for payments to be made individuals who were relocated during World War II. Section 205(f) clarifies the tax treatment of these payments by stating that the Internal Revenue laws of the U.S. will treat amounts paid to an eligible person under the section as damages for human suffering. As such, the payments will not be included in the gross income of the recipient.

California, in AB 4132 (Floyd, Stats. 1988, Ch. 1234), enacted a specific exclusion from gross income for reparation payments made to redress the injustice done to U.S. citizens and resident aliens of Japanese ancestry who were interned during World War II. This provision was contingent upon the federal Act being signed by the President and treating amounts payable under that legislation as damages for human suffering.

IV. Trade and Competitiveness Act
(P.L. 100-418, Signed August 23,1988)

Section 1941 of this Act repeals Chapter 45 of the Internal Revenue Code of 1986 (the Windfall Profit Tax) and makes conforming amendments throughout the Internal Revenue Code. This repeal does not impact the California Revenue and Taxation Code as the state did not impose the Windfall Profit Tax.

V. Independent Agencies Appropriations Act, 1989
(P.L. 100-440, Signed September 22, 1988)

In the portion of the Act dealing with salaries and expenses of the United States Tax Court requires that written certification of travel expenses are required before payment under the appropriation may be made.

Budget control language of this nature will not require California to enact any type of state level legislation. Compliance to the federal requirement will provide sufficient evidence under the reimbursed travel rules contained in the California Revenue and Taxation Code.

VI. Coast Guard Authorization Act
(P.L. 100-448, Signed September 28, 1988)

Section 6 of this Act increase the maximum amounts in or transfers to the Boat Safety Account as well as extend the expenditure authority expiration date which are contained in Sections 9503 and 9504 of the Internal Revenue Code of 1986.

The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not contain any provisions comparable to the Boat Safety Program provisions of the Internal Revenue Code of 1986.

VII. Anti-Drug Abuse Act
(P.L. 100-690, Signed November 18, 1988)

Under this Act, Section 6103(i) of the Internal Revenue Code of 1986 is amended to allow the IRS to disclose returns on cash transaction to federal officers and employees administering federal criminal statutes not relating to tax administration. In addition, this Act amends Section 7608 of the Internal Revenue Code of 1986 to enhance the undercover capabilities of the Internal Revenue Service.

APPENDIX I
1988 FEDERAL TECHNICAL & MISC. REVENUE ACT
(INCLUDES 1988 FAMILY SUPPORT ACT)
ESTIMATED STATE REVENUE IMPACT *
(in millions)

Act Sect	Provision	Fiscal Years 89/90	90/91
III-SIMPLIFICATION & CLARIFICATION PROVISIONS			
3001	Diesel Fuel Excise Tax	n/a	n/a
3001-b	Diesel Fuel Excise Tax	n/a	n/a
3002	Diesel Fuel Excise Tax	n/a	n/a
3011	Continuation Rules	a/	a/
3021	Employee Benefit Plans	a/	a/
3031	Estate Tax Valuation	n/a	n/a
3041	Indian Fishing Rights	-0.5	-0.5
IV-EXTENSION & MODIFICATION OF EXPIRING TAX PROVISIONS			
4001	Educational Assistance	---	---
4002	Group Legal Services	---	---
4003	Low Income Housing	n/a	n/a
4004	Low Income Housing	n/a	n/a
4005	First Home Buyers	---	---
4006	Energy Credits	-4.0	a/
4007	R&D Credit	a/	a/
4008-a	R&D Deduction	1.5	0.5
4008-b	Business Credits	n/a	n/a
4008-c1	Orphan Drug Credit	n/a	n/a
4008-c2	IRS Assess Deficiency	n/a	n/a
4009	Guide for R & E Expend	n/a	n/a
4010	Targeted Job Credit	n/a	n/a
4011	Mutual Funds	a/	a/
4012-a	FSLIC	b/	b/
4012-b	FSLIC	b/	b/
4012-c	FSLIC	b/	b/
V-REVENUE INCREASE PROVISIONS			
5001	Est. Tax Penalty-Corp	n/a	n/a
5011	Mortality Expenses	c/	c/
5012	Endowment Contracts	4.0	7.0
5013	Group Term Life Ins.	0.5	0.5
5021	Alaska Native Corps	n/a	n/a
5031	Valuation Annuities	0.3	0.3
5041	Long Term Contracts	d/	d/
5051	Private Activity Bonds	n/a	n/a
5061	Excise Tax Prov.	n/a	n/a
5071	Bad Check Penalty	n/a	n/a
5073	Residential Telephone	1.1	1.0
5074	Partnership UBI	a/	a/
5075	Wash Sale Rules	1.0	0.2
5076	Installment Sales	d/	d/

APPENDIX I
1988 FEDERAL TECHNICAL & MISC. REVENUE ACT
(INCLUDES 1988 FAMILY SUPPORT ACT)
ESTIMATED STATE REVENUE IMPACT *
(in millions)

Act Sect	Provision	Fiscal Years 89/90	90/91
5077	NOL Acquisitions	0.7	0.7
	VI-OTHER SUBSTANTIVE REVENUE PROVISIONS		
6001	School Contributions	a/	a/
6002	Surv Spouse Rollover	-0.6	-0.4
6003	Crew Meals Limitation	a/	a/
6004	Innocent Spouse	e/	e/
6005	C McAuliffe Fellowship	a/	a/
6006	Unearned Minor Income	a/	a/
6007	Jury Duty Pay	a/	a/
6008	Rural Mail Carrier	-0.1	-0.1
6009	Savings Bonds-Tuition	n/a	n/a
6010	Student Dep Exemption	1.0	1.0
6011	Principal Residence	-1.0	-0.8
6026-a	Authors,Photo.& Artist	-1.5	-0.1
6026-b	Producers of Animals	-9.0	-7.0
6026-c	Pistachio Nuts	-1.0	-0.3
6027	Class Life-Ag or Hort.	0.2	0.2
6028	Class Life-Farm Prop.	2.0	2.0
6029	Deprec. Certain Trees	-0.2	-0.4
6030	Livestock Proceeds	a/	a/
6031	Certain Repledges	d/	d/
6032	Nongrantor Trusts	a/	a/
6033	Crop Insurance	-0.5	a/
6051-a	Church Plans	a/	a/
6051-b	Cafeteria Plans	a/	a/
6052	Annuity Contracts	a/	a/
6053	Govern. & Church Plans	a/	a/
6054	State & Local Plans	a/	a/
6055	Min Part Standards	a/	a/
6057	State Coins	a/	a/
6058	Fund Employer Plans	a/	a/
6059	Police & Firefighters	a/	a/
6060	Excise Taxes	n/a	n/a
6061	Employer Securities	a/	a/
6062	Collect. Bargain Agree	a/	a/
6063	Dep. Care-Cafeteria	a/	a/
6064	Deferred Comp-Govt.	-1.0	-1.0
6066	Cargo & Pass. Fringe	a/	a/
6067	Bridge Banks	a/	a/
6068	Inc. Average Lump-Sum	-0.2	-0.2
6070	Part-Time Employ Bene	a/	a/
6071	Rural Telephone Coops	-0.2	-0.2
6076	Qualified Gp. Dividend	n/a	n/a
6077	Special Est. Tax Pay.	n/a	n/a
6078	Church Life Insurance	a/	a/

APPENDIX I
1988 FEDERAL TECHNICAL & MISC. REVENUE ACT
(INCLUDES 1988 FAMILY SUPPORT ACT)
ESTIMATED STATE REVENUE IMPACT *
(in millions)

Act Sect	Provision	Fiscal Years 89/90	90/91
6079-a	Corp Adj Current Earn	---	-0.5
6079-b	Qualified Assignment	a/	a/
6080	Variable Annuities	a/	a/
6101	Excise Tax Modified	n/a	n/a
6126	Dual Resident Comp	n/a	n/a
6127	Passive Foreign Invest	n/a	n/a
6128	Foreign Corp Residence	n/a	n/a
6132	Virgin Islands	n/a	n/a
6133	Portfolio Interest	n/a	n/a
6134	Gambling NR Collection	n/a	n/a
6135	Foreign Insurance	n/a	n/a
6136	Enjebi Trust Fund	a/	a/
6137	Judicial Employ Abroad	n/a	n/a
6138	Resident Alien	n/a	n/a
6139	Bermuda & Barbados	n/a	n/a
6140	Awards by Guam	n/a	n/a
6151	Special Use Valuation	n/a	n/a
6152	QTIP Rules	n/a	n/a
6176	Small-Issue Bonds	n/a	n/a
6177	Rebate Safe Harbor	n/a	n/a
6178	Mortgage Bonds Price	n/a	n/a
6179	Hazardous Act. Bonds	n/a	n/a
6180	Exempt Facilty Bonds	n/a	n/a
6181	Bona Fide Debt	n/a	n/a
6182	Fire Dept Bonds	a/	a/
6183	Pooled Finance Bonds	n/a	n/a
6201	Games Of Chance	n/a	n/a
6202	Hospital Service	---	---
6203	Rural Utilities	n/a	n/a
6204	Priv. Operating Found	n/a	n/a
6227	Taxpayer Rights	n/a	n/a
6236	Levy & Lien Provision	n/a	n/a
6239	TP Proceedings	n/a	n/a
6243	Tax Court Jurisdict	n/a	n/a
6251	Return Information	n/a	n/a
6253	Secretarial Authority	n/a	n/a
6254	Windfall Profit Tax	n/a	n/a
6276	Refunds to Fiduciary	a/	a/
6277	NOL Bankruptcy	n/a	n/a
6278	Corps & Holding Co.	n/a	n/a
6279-a	Corps & Holding Co.	n/a	n/a
6280	Corps & Holding Co.	n/a	n/a
6281	Contrib of Inventory	n/a	n/a
6282	Res. Coop Units	-0.3	-0.3
6301	Treasury Bonds	n/a	n/a
6302	Fuel Credit	n/a	n/a
6303	Adjusted Book Income	a/	a/
6304	Fuel Credit	n/a	n/a

APPENDIX I
1988 FEDERAL TECHNICAL & MISC. REVENUE ACT
(INCLUDES 1988 FAMILY SUPPORT ACT)
ESTIMATED STATE REVENUE IMPACT *
(in millions)

Act Sect	Provision	Fiscal Years 89/90	90/91
6305	Employment Taxes	a/	a/

FAMILY SUPPORT ACT
VII-FUNDING PROVISIONS

Act Sect	Provision	89/90	90/91
701	Tax Refund Offset	n/a	n/a
702	Limit Reimbursement	3.5	3.5
703	Child & Dep Care Cr	7.0	7.0
704	Dependent SSN	a/	a/
TOTAL		(T)	(T)

(T) Grand totals are not provided since estimates for FSLIC provisions are still pending. Totals without regard to FSLIC are as follows: 1989-90 +$2.7 mil
1990-91 +$12.1 mil
If estimates for 1987 & 1988 Federal Act provisions on installment sales and long term contracts are included, totals are: 1989-90 +$180.7 mil
1990-91 +$162.1 mil

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* Assumes a 1989 enactment date after June 30 and includes any behavioral reporting effects that will occur irrespective of state conformity. Identification of these effects will be made as conformity legislation is introduced.

N/A = Not Applicable

a/ Negligible Impact.
b/ Significant loss. Estimates are pending.
c/ Combined with Act Section 5012 estimate.
d/ Estimates are not provided since California has not conformed to basic changes in the 1987 Federal Act. Refer to Total (T) for this impact.
e/ Omitted since only one taxpayer may be affected.

FTB/RAS
03/15/89

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1001 (a)(1)	RATE OF TAX - UNCLAIMED CASH	4895	6867(b)	18654	N/A	TECHNICAL-Modifies section by using cross reference to rate of tax section rather than stating the exact rate in this section.
1001 (a)(2)	RATE OF TAX - ACCUMULATED EARNINGS TAX	1175	531	N/A	N/A	NOT APPLICABLE - Changes the rate of the accumulated earnings tax to a flat 28% for taxable years beginning after 12/31/87 rather than the previously specified graduated rate structure.
1001 (a)(3)	PHASEOUT OF PERSONAL EXEMPTIONS	405	1(g)(2)			NOT APPLICABLE - California did not conform to the phase out of personal exemptions and therefore there is no need to enact this provision which prevents the avoidance of the full impact of phase out by married couples filing separate returns.
1001 (b)(1)	STANDARD DEDUCTION FOR ELDERLY/BLIND DEPENDENTS	435	63(c)(5)	17073	N/A	NOT APPLICABLE - California allows additional personal exemption credits to blind and elderly individuals rather than an additional standard deduction. No technical correction specifying interaction with rules for persons claimed as dependents is needed.
1001 (b)(2)	FILING THRESHOLD - ELDERLY/BLIND	440	6012(a)(1)	18401	N/A	NOT APPLICABLE - The state filing thresholds are based on either Gross Income or Adjusted Gross Income amounts and were adjusted to reflect the lowering of tax rates in 1987.
1001 (b)(3)	THIRD-PARTY REIMBURSEMENTS	580	62	17072	N/A	TECHNICAL - Provides statutory authority for the IRS regulation that when an employee is reimbursed, that employee is permitted a business expense deduction (above-the-line) whether the reimbursement is provided by the employer or by a third party.
1001 (b)(3)(B	EMPLOYEE EXPENSES REIMBURSED BY POLITICAL ORGANIZATIONS ARE ABOVE THE LINE DEDUCTIONS	3885	527	N/A	23701r	TECHNICAL - Conforming amendment to incorporate statutory authority for IRS regulations relating to reimbursement of employee expenses which may be deducted above-the-line in the provision relating to the tax treatment of political organizations.
1001 (c)	EARNED INCOME CREDIT	585	32	N/A	N/A	NOT APPLICABLE - The state does not have an earned income credit but instead provides a low income credit which differs substantially with the provisions of the federal earned income credit.
1001 (d)	PRIVATE FOUNDATION RULES, DEFINITION OF N/R ALIENS, WITHHOLDING ON N/R ALIENS	4840	7701(b)(5)	N/A	N/A	NOT APPLICABLE - California does not conform to the federal treatment of nonresident aliens nor the rules for imposition of excise taxes on private foundations.
1001 (e)	EXCLUDES SOCIAL SECURITY BENEFITS FROM DEFINITION OF EARNED INCOME	5032	86	17087	N/A	NOT APPLICABLE - California has never conformed to the partial taxation of Social Security and Railroad Retirement benefits and thus has never included those benefits in earned income.
1001 (f)	PROVIDES ORDERING RULES FOR APPLICATION OF LIMITS ON EXPENSES SUBJECT TO THE 2% FLOOR	480	67	17076	N/A	TECHNICAL - The $3,000 limit on congressional away-from-home expenses is to be applied after reducing the the total expenses by the 2% floor. This method insures the maximum amount possible will be deductible. Also specifies rules for Estates and Trusts.
1001 (g)	LIMITATIONS ON MEAL AND ENTERTAINMENT EXPENSES	526	274	17201	24443	TECHNICAL - Clarifies that expenses excepted from the limitations are not to be limited to 80%. Also the Code is amended to apply the percentage limit at the employee level for meal expenses which are deductible as moving expenses.
1001 (h)	SPECIAL RULE FOR DETERMINING IF AN ACTIVITY IS NOT ENGAGED IN FOR PROFIT CLARIFIED	5076	183	17201	N/A	TECHNICAL - Clarifies the application of the testing period when a taxpayer elects to test the activity beginning with the fifth year of engaging in the activity. Provides that profit is necessary

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1001 (h)	HOME OFFICE DEDUCTION	520	280A	17201	N/A	TECHNICAL - Specifically adds a reference to rental activity as well as trade or business activity in the gross income limitation. Also, carryover of unused deductions will continue to be limited to the income from the business in which it arose.
1002	CLARIFICATION OF THE MODIFIED ACCELERATED COST RECOVERY SYSTEM (MACRS)	1130	168	17250	24349.5	TECHNICAL - Items include the life of railroad grading, that 5-year research property must be personal property, when an election to use the 150% declining balance method may be made, averaging convention, churning, tax-exempt entities and transferees.
1002 (a)	AMENDMENTS RELATED TO THE AMOUNT OF THE INVESTMENT TAX CREDIT	5015	46	N/A	N/A	NOT APPLICABLE - Clerical amendments to reflect the 86 Act change from ACRS to MACRS. California has never allowed an investment tax credit.
1002 (a)	CROSS REFERENCES UPDATED IN SECTION DEALING WITH RECAPTURE OF INVESTMENT CREDIT	5016	47	N/A	N/A	NOT APPLICABLE - Various cross references are changed to reflect the changes made by the enactment of MACRS versus ACRS. California has never conformed to the allowance of an investment tax credit.
1002 (a)	DEFINITIONS AND SPECIAL RULES FOR INVESTMENT TAX CREDIT	760	48	N/A	N/A	NOT APPLICABLE - Amends various cross references to Sec. 168 to reflect enactment of MACRS versus ACRS and clarifies treatment of sound recordings. California has never conformed to the allowance of an investment tax credit.
1002 (a)	ALTERNATIVE MINIMUM TAX CLARIFIED WITH RESPECT TO COORDINATION WITH TRANSITIONAL RULES	5022	56	17062	23456	TECHNICAL - Identifies the specific 86 Act Section transitional rules which prevent the computation of depreciation on assets placed in service in 1987 or later years from being made (for Alternative Minimum Tax) under the alternative depreciation system
1002 (a)	AMENDMENTS RELATED TO AMORTIZATION OF COST OF ACQUIRING A LEASE	5074	178	17201	24373	TECHNICAL - Replaces cross references to specific IRC code deduction sections with the general description "deduction allowable to a lesee for exhaustion, wear and tear, obsolescence, or amortization". B&CTL not conformed to 86 Act. PITL conformed.
1002 (a)	FOREIGN CORPORATIONS MUST USE ALTERNATIVE DEPRECIATION SYSTEM FOR CALCULATING E & P	1158	312	N/A	24484	TECHNICAL - In computing earnings and profits of a corporation which derives less than 20% of its gross income from U.S. sources, depreciation must be calculated using straight-line (no salvage) over the class life (the alternative depreciation system).
1002 (a)	CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS	5114	381(c)	17321	24591	CLERICAL - Changes the title of paragraph (c)(24) to reflect the 86 Act change from ACRS to MACRS.
1002 (a)	GAIN FROM DISPOSITION OF CERTAIN DEPRECIABLE PROPERTY	5261	1250(d)(11)	18151	24990	TECHNICAL - The 86 TRA repealed Sec. 1250(d)(11) and this Act section repeals the same provision again.
1002 (b1&c8)	ELECTION TO EXPENSE DEPRECIABLE BUSINESS ASSETS	2365	179	17201	23802(f)	TECHNICAL - Costs in excess of the taxable income limitation may be carried forward but are subject to the limitation in the later year as though those carryover amounts were assets placed in service in the later year. Transition rule also clarified.
1002 (b2)	LIMITATION ON DEPRECIATION ON CERTAIN PROPERTY USED FOR PERSONAL PURPOSES	1160	280F	17201	24349.1	TECHNICAL - Coordinates the provisions of Sec. 179 with this section to insure that employee use of listed property which the employer is expensing is required as a condition of employment and is for the convenience of the employer before being qualified

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

ct Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1002 (e)	GENERAL BUSINESS CREDIT ORDERING RULES	730	38	N/A	N/A	NOT APPLICABLE - California has not conformed to the allowance of a general business credit.
1002 (e)	INVESTMENT CREDIT BASIS ADJUSTMENTS	755	49	N/A	N/A	NOT APPLICABLE - California has never allowed an investment tax credit.
1002 (h)	RESEARCH CREDIT LIMITATION ON INDIVIDUALS	740	41	17052.12	23609	TECHNICAL - The 86 TRA limited the amount of credit available to individuals coming from pass-thru entities. This provision adds language which treats the disallowed amount as eligible under the general carryback and carryover rules but subject to limits
1002 (h)	RESEARCH CREDIT	740	6411	N/A	N/A	NOT APPLICABLE - Deletes a reference to unused research credit in the paragraph dealing with consolidated returns with tentative carryback and refund adjustments. California has not conformed to carryback rules.
1002 (i)	PAYMENTS FOR THE USE OF PROPERTY OR SERVICES	1130	467	17551	24688	TECHNICAL - The statutory recovery period (used to determine whether a disqualified leaseback has occured) is modified to include railroad grading or tunnel bores with an assigned 50 year recovery period.
1002 (i)	DEPRECIATION RECAPTURE	1130	1245	18151	24990	TECHNICAL - Includes railroad grading and tunnel bores depreciation as being subject to recapture under the rules for personal property and not real property.
1002 (ii)	TRADEMARK AND TRADE NAME	1125	167	17201	24349	TECHNICAL - Provides code language which states that no depreciation or amortization deduction is allowed for any trademark or trade name expenditure. The code section which allowed amortization was repealed by the 86 TRA but MACRS needed clarification.
1002 (l)	DENIES CARRYBACK OF LOW INCOME HOUSING CREDIT TO YEARS BEFORE 1987	730	39	17039	23036	NOT APPLICABLE - California does not allow carrybacks of either deductions or credits.
1002 (l)	LOW-INCOME RENTAL HOUSING CREDIT	745	42	17058	23610.5	TECHNICAL - Makes numerous changes to the low income housing credit. See discussion of Act Sections 4003 and 4004 for a discussion of the technical changes as well as the new substantive provisions.
1002 (l)	DEFINITION OF REGULAR TAX FOR ALTERNATIVE MINIMUM TAX	5021	55	17062	23400	TECHNICAL - Regular tax clarified to not include the increase to tax required under Sec. 42(k) At-Risk Rules for the Low Income Housing Credit.
1002 (m)	MERCHANT MARINE CAPITAL CONSTRUCTION FUND	5447	7518	N/A	N/A	NOT APPLICABLE - Clerical changes. California does not conform to the federal provisions providing tax incentives relating to merchant marine capital construction funds.
1003 (a)	CONFORMING AMENDMENTS DUE TO REPEAL OF CAPITAL GAINS PREFERENTIAL TREATMENT	5071	172	17276	24416	NOT APPLICABLE - An obsolete reference to the capital gains deduction is repealed. For years prior to 1987 California provided preferential treatment to capital gains through the use of exclusions from income rather than a capital gain deduction.
1003 (a)	LIMITATION ON CAPITAL LOSSES OF NONCORPORATE TAXPAYERS	482	1212	18155	24990.5	NOT APPLICABLE - This change in the calculation of the carryover of capital losses to future years is made in order to disallow the amount of loss equal to the personal exemption deduction. The state uses credits versus deductions so it does not apply.
1003 (a)	CLERICAL AMENDMENT TO WITHHOLDING ALLOWANCE CALCULATIONS	5327	3402	18804	N/A	CLERICAL - TRA 86 modified the internal numbering within Sec. 62 to which the withholding allowance calculations made reference. This change changes the reference to the correct paragraph number in that renumbered section.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1003 (b)	WITHHOLDING OF TAX ON DISPOSITIONS OF US REAL PROPERTY INTERESTS (FIRPTA)	4855	1445	18805(a)(2)	26131(a)(2)	TECHNICAL - Modifies the withholding rate to recognize the regulatory use of a lower withholding rate. California adopted the provision to the extent that Calif. realty is sold but in an amount equal to 1/3 of the federal withholding.
1003 (c)	CONFORMING AMENDMENTS TO THE REPEAL OF ALTERNATIVE TAX RATE FOR CORPORATE CAPITAL GAINS	1050	593	N/A	N/A	NOT APPLICABLE - Certain financial institutions must exclude capital gains in computing the bad debt reserve deduction when utilizing the percentage-of-taxable-income method. California has never provided preferential treatment of corporate capital gain.
1003 (c)	CONFORMING AMENDMENTS TO THE REPEAL OF THE ALTERNATIVE TAX ON CORPORATE CAPITAL GAINS	5255	1201	N/A	24990.5	NOT APPLICABLE - Makes technical modifications to the section dealing with the alternative tax for corporations. California has never adopted preferential treatment of corporate capital gains in the Bank and Corporation Tax Law.
1003 (d)	INCENTIVE STOCK OPTIONS (ISO)	1660	422A	17514	24621	TECHNICAL - Provides that an option which by its specific terms is not an incentive stock option will not be treated as an ISO. The limitation on ISO's is simplified to provide that options granted in a year in excess of $100,000 will not be an ISO.
1004 (a)	INCOME FROM DISCHARGE OF FARM INDEBTEDNESS	1190	108	17131	24307	TECHNICAL - TRA 86 stated that a income from discharge of certain farm indebtedness by a solvent farmer was to be given the same tax treatment as discharge by an insolvent debtor. TAMRA amends the section to specify each of these rules.
1004 (a)	DISCHARGE OF FARM INDEBTEDNESS	1190	1017	18031	24918	TECHNICAL - Amends section to specify the order ar type of property which is to have its basis reduce by the discharge of qualified farm indebtedness. Previously the section used a cross referencing system.
1004 (b)	CAPITAL GAIN TREATMENT FOR SALES OF DAIRY CATTLE UNDER MILK TERMINATION PROGRAM	1055	1202 *ACT*	18162	N/A	SUBSTANTIVE - Allows sales made in September 1987 under a valid contract with the Dept of Agriculture to qualify for capital gain treatment, thus extending the 86 TRA Sec. 406 non-code provision to which California conformed for individuals by one month.
1004 (c)	RECAPTURE OF MINING EXPLORATION EXPENSES UPON SALE OF INTEREST IN THE PROPERTY	910	1254(a)	18151	24990	TECHNICAL - Section amended to take into account the amount of expenses previously recaptured when the taxpayer elects (under 617(b)(1)(A)) to include in gross income, when the mine becomes productive, the amount of exploration expenses taken previously.
1005 (a)	PASSIVE LOSS RULES	2230	469	17561	24692	TECHNICAL - Clarifies portfolio income, restates deduction for suspended PALs, rental real estate activities clarified, eliminates overlap of Sec. 280A, adds rules for affiliated groups and distribution by estate/trust and treatment of pre-87 inst sales.
1005 (c)	INTEREST EXPENSE LIMITATION	540	163	17201	24344	TECHNICAL - Takes into account passive loss rules, makes consistency changes to several definitions, clarifies the phase-in rule, and adds rules for certain refinancing of debt, renting of residence, security interests, divorce as well as estates/trusts.
1005 (c)(15)	TREATMENT OF LOANS WITH BELOW MARKET INTEREST - GIFT LOANS	543	7872(d)	17024.5(a)(3)	24993	TECHNICAL - Corrects a cross reference to the definition of Net Investment Income.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1006	QUALIFICATION FOR REGULATED INVESTMENT COMPANY STATUS	4000	851	17145	24412	TECHNICAL - TAMRA clarifies the ninety percent test relating to a RIC's partnership or trust income and the thirty percent test adding options, futures, and forward contracts to the list of restricted income items as well as clarifying the 5 day rule.
1006	TAXATION OF REGULATED INVESTMENT COMPANIES	4005	852	17145	24412	NOT APPLICABLE - TAMRA clarifies the rules for the excise tax imposed on the undistributed income of a RIC to which California has not conformed.
1006	DIVIDENDS PAID BY REGULATED INVESTMENT COMPANIES	5198	855	N/A	24412	CLERICAL - Modifies a cross reference to take into account technical changes made by TAMRA.
1006	QUALIFICATION AND TAXATION OF REAL ESTATE INVESTMENT TRUSTS	4025	856	17740	24413	TECHNICAL - TAMRA modifies the excise tax imposed on undistributed REIT income, clarifies the rules for qualification as a REIT in the year the REIT liquidates and clarifies the rule for rent and interest income.
1006	DISTRIBUTIONS BY REAL ESTATE INVESTMENT TRUSTS	4030	857	17740	24413	TECHNICAL - Clarifies the interaction of capital gain net income in years when the REIT has a net operating loss, requires inclusion of forclosure income in distribution computation and deems dividends declared in the final quarter as recieved on 12/31.
1006	TREATMENT OF AMOUNTS RECEIVED ON RETIREMENT OR SALE OR EXCHANGE OF DEBT INSTRUMENTS	5263	1271	18151	24990	CLERICAL - Corrects a cross reference.
1006	OTHER DEFINITIONS AND SPECIAL RULES	5264	1275	18151	24990	CLERICAL - Corrects a cross reference.
1006	TREATMENT OF ORIGINAL ISSUE DISCOUNT ON TAX-EXEMPT OBLIGATIONS	5269	1288	18151	24990	CLERICAL - Corrects a cross reference.
1006	INTEREST INFO REPORTING REQUIREMENTS FOR REMICs	4045	6049	18803	N/A	TECHNICAL - Clarifies the point at which amounts are treated as paid and requires the info return to state the adjusted issue price rather than the issue price.
1006 (a)	CORPORATE TAX RATE	700	15	N/A	23151	TECHNICAL - The corporate tax rate was reduced July 1, 1987 and corporations use a blended rate to calculate the tax. TAMRA clarified the provision when other Code sections require the use of the "highest" rate to mean a weighted average calculation.
1006 (b)	LIMITATIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANY	5197	854	N/A	24412	CLERICAL - Amended to take into account the repeal of the capital gains deduction by the 86 TRA.
1006 (c)	EXTRAORDINARY DIVIDENDS	890	1059	N/A	24966	TECHNICAL - TAMRA clarifies the dividend announcement date, the exception for stock held during the entire existence of the corporation, qualified preferred dividends and treatment of partial liquidations.
1006 (d)	LIMITATIONS ON NOL'S AND OTHER CARRYFORWARDS	1070	382	17321	24592	TECHNICAL - Clarifies valuation of old loss corporation, definition of new loss corporation, interaction of ownership change with change in ownership of preferred stock, bankrupt corp, recognition of gainand eff. dates. See also CCH 1075-78 & 1082-86.

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Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1006 (e)	LIQUIDATIONS - RELATED PARTY RULES	885	267	17201	24427	TECHNICAL - Clarifies the rule for losses in complete liquidations by restating the exception.
1006 (e)	CORPORATE DISTRIBUTIONS - PROPERTY DISTRIBUTED TO SHAREHOLDERS	830	301(b)	17321	24452	TECHNICAL - Amount of distribution clarified and section conformed with the repeal of the General Utilities rule by the 86 TRA which provides that in a nonliquidating distribution to any shareholder, gain is recognized to the distributing corporation.
1006 (e)	DISTRIBUTIONS OF PROPERTY - BASIS	830	301(d)	17321	24454	TECHNICAL - TAMRA amends this subsection so that property in the hands of a corporate distributee that was received in a Sec. 301 distribution is the same as it would be in the hands of a noncorporate distributee.
1006 (e)	SPECIAL RULE FOR HOLDING PERIOD OF APPRECIATED PROPERTY DISTRIBUTED TO CORPORATION	830	301(e)	17321	24454.2	TECHNICAL - This subsection was repealed as deadwood by TAMRA.
1006 (e)	DISTRIBUTIONS NOT IN COMPLETE LIQUIDATION	835	311	N/A	24481	TECHNICAL - TAMRA provides regulatory authority for distributions of partnership or trust interests by corporations as well as clarifying taxability of corporate liquidations of appreciated property in nonliquidating distributions. See also CCH 845.
1006 (e)	BASIS OF PARENT CORPORATION IN PROPERTY OF 80% OWNED LIQUIDATING SUBSIDIARY	850	334	17321	24504	TECHNICAL - Provides that if gain is recognized by an 80% owned liquidating corporation on distribution of property to its parent, the parents basis in the property received is the FMV of the property at the time of the liquidating distribution.
1006 (e)	BASIS IN CORPORATE LIQUIDATIONS	855	336	N/A	24511	TECHNICAL - Clarifies election to treat subsidiary stock sale as an asset transfer and expands property subject to limitation on recognition of loss rules as well as clarifying those rules in the case of a distribution to 80% parent corp. See CCH 860.
1006 (e)	DISTRIBUTIONS TO TAX EXEMPT CORPORATION AND REGULATORY AUTHORITY TO PREVENT CIRCUMVENTION	865	337	N/A	24512	TECHNICAL - Clarifies rules for distributions to tax exempt organizations and expends the authority granted to the IRS to prevent circumvention of the 86 TRA repeal of General Utilities. See also CCH 875.
1006 (e)	CLEANUP OF REPEAL OF GENERAL UTILITIES RULE	5106	338	N/A	24519	CLERICAL - Sec. 338(h)(7) repealed as deadwood after 86 TRA repeal of General Utilities rule and Sec. 338(c) to which this rule related.
1006 (e)	CLEANUP OF REPEAL OF GENERAL UTILITIES RULE	5107	341	17321	N/A	CLERICAL - Cleanup phrasing in section relating to collapsible corporations to reflect the 86 TRA repeal of the General Utilities rule.
1006 (e)	REORGANIZATIONS - TRANSFERS TO FOREIGN CORPORATIONS	815	367	17024.5(b) (9)	24561	TECHNICAL - TAMRA treats the transfer of property to a foreign corporation (even though it would otherwise qualify as a tax-free reorganization) as though it had taken place in a liquidation (i.e. gain will be recognized unless regs provide otherwise).
1006 (e)	IMPACT OF REPEAL OF GENERAL UTILITIES RULE ON DISTRIBUTIONS OF PARTNERSHIP AND TRUST INT	835	386	17321	24585	TECHNICAL - TAMRA repeals Sec. 836 but amends Sec. 311 to restate and provide for regulatory authority for the Secretary to issue regulations regarding the amount of gain recognized on a nonliquidating distribution of this type of property.
1006 (e)	INSTALLMENT METHOD OF ACCOUNTING - CERTAIN LIQUIDATING DISTRIBUTIONS BY S CORPORATIONS	2305	453B	17551	24667	TECHNICAL - TAMRA provides a rule for the distribution by an S corporation of an installment obligation to allow the shareholder to report the gain over the period of the note and not subject the S corporation to tax on the distribution.

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Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

ct Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1006 (e)	HOLDING PERIOD OF PROPERTY - REPEAL OF GENERAL UTILITIES RULE	5257	1223	18151	24490	CLERICAL - Changes the cross references to other sections to delete the Sec. 301(e) which was repealed by a technical change in TAMRA.
1006 (e)	GAIN FROM DISTRIBUTIONS OF STOCK IN CERTAIN FOREIGN CORPORATIONS	905	1248	18151	24990	TECHNICAL - TAMRA makes conforming changes to this section to reflect the 86 TRA repeal of the General Utilities rule.
1006 (f)	S CORPORATIONS - ELECTION, REVOCATION, TERMINATION	5277	1362	N/A	23801	TECHNICAL - Clarifies the special rule for options and commodity dealers by placing it in its own paragraph and adding definitions.
1006 (f)	DISTRIBUTION OF APPRECIATED PROPERTY BY S CORPORATIONS	1035	1363(d)&(e)	N/A	23802	TECHNICAL - The repeal of the General Utilities rule and the tax on built-in gain of S corporations made rules which mandate recognition of gain on the distribution of appreciated property obsolete. TAMRA therefore repealed those provisions.
1006 (f)	PASS-THRU OF ITEMS TO SHAREHOLDERS	5279	1366	17087.5	23800	CLERICAL - Corrects a cross reference.
1006 (f)	TAX ON BUILT-IN GAINS OF S CORPORATIONS	955	1374	N/A	23809	TECHNICAL - Clarifies the tax base for built-in gains, definitions of recognized built-in gain or loss, carryover of capital losses, transfer of assets from C to S, replacement assets acquired in tax-free transaction and effective dates. CCH 960-980.
1006 (f)	TAX IMPOSED WHEN PASSIVE INVESTMENT INCOME OF CORP HAVING SUBCHAPTER C EARNINGS OVER 25%	5281	1375	N/A	23811	CLERICAL - Corrects cross reference and reorganizes the section.
1006 (g)	TRANSITIONAL RULES FOR RECOGNITION OF GAIN OR LOSS ON LIQUIDATING SALES AND DISTRIBUTIONS.	990	337 *ACT*	N/A	24513	TECHNICAL - Section 633 of the 86 TRA is modified by TAMRA relating to corporations that qualify, nonliquidating distributions, one-month liquidations, installment obligations, tax-avoidance transfers and correct binding contract exceptions. See 995-1025.
1006 (h)	ALLOCATION OF PURCHASE PRICE IN CERTAIN SALES OF ASSETS	895	1060(d)	18031	24966.2	TECHNICAL - Clarifies the valuation of goodwill or going concern value when partnership property or an interest in a partnership is distributed. Also clarifies information return portion of this section.
1006 (h)	INFORMATION RETURNS - CERTAIN ASSET ALLOCATIONS	4735	6724	18681.1 (d)	N/A	TECHNICAL - Clarifies that the information reporting required under Sec. 1060(b) is to be considered an info return for purposes of the penalty provisions. Failure to file penalty is $50 for failure to file the return or $5 for failure to include info.
1006 (i)	INSTALLMENT OBLIGATION AND RELATED PARTY SALES	2300	453	17551	24667	TECHNICAL - Clarifies distribution of installment obligations in order for the recognition to occur as the note is paid (the corporate sale must have been made in one transaction) as well as treatment of sales of depreciable property to a related party.
1006 (j)	AMORTIZABLE BOND PREMIUM	600	171	17201	24360	TECHNICAL - Changes amortizable bond premium on taxable bonds acquired after 1987 to an offset of interest income rather than an interest deduction. California has conformed to the treatment of bond premium as interest only for non-corporate taxpayers.
1006 (j)	AMORTIZABLE BOND PREMIUM	600	1016	18036	24916	TECHNICAL - A reduction in basis is required for amortizable bond premium that is applied to reduce interest payments (under Sec. 171(e)).

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Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1006 (t)	TAXATION OF REAL ESTATE MORTGAGE INVESTMENT CONDUITS	5201	860A	N/A	24870	CLERICAL - Corrects a drafting error in the section.
1006 (t)	TAX ON FORCLOSURE INCOME OF REAL ESTATE MORTGAGE INVESTMENT CONDUITS	4050	860C	N/A	24870	TECHNICAL - TAMRA clarifies the computation of the net income or loss of a REMIC subject to tax to allow a deduction for the tax imposed on forclosure income of the REMIC.
1006 (t)	QUALIFICATION AS A REAL ESTATE MORTGAGE INVESTMENT CONDUIT	4035	860D	N/A	24870	TECHNICAL - Modifies the testing month for determining qualification as a REMIC and specifies that the asset test may not be applied during the period of a REMIC's liquidation.
1006 (t)	TAX ON REMIC WITH TAX-EXEMPT RESIDUAL INTEREST HOLDER	4060	860E	N/A	24870	TECHNICAL - TAMRA requires the payment of a quarterly tax if a tax-exempt holds a residual interest in the REMIC. In addition clarification is made when holders of residual interests are members of an affiliated group. See also CCH 4075.
1006 (t)	PROHIBITED TRANSACTIONS AND RETURNS OF REAL ESTATE MORTGAGE INVESTMENT CONDUITS	4065	860F	N/A	24871	TECHNICAL - Clarifies the exception from prohibited transaction status of certain repurchases of mortgages and so-called "clean-up calls". In addition clarification is made of the return filing requirements for REMIC's. See also CCH 4080.
1006 (t)	TAX ON CONTRIBUTIONS TO REAL ESTATE MORTGAGE INVESTMENT CONDUITS MADE AFTER STARTUP DAY	4055	860G	N/A	24870	TECHNICAL - TAMRA imposes a 100 percent excise tax on certain contributions of property after the startup day, expands the definition of regular interest, requires the issuance of residual interests on the startup day and modifies qualified mortgages.
1006 (u)	REAL ESTATE MORTGAGE INVESTMENT CONDUITS	4040	7701(a)(19)	17020.9	23045.5	TECHNICAL - In determining whether an interest in a REMIC qualifies for purposes of defining a domestic building and loan association, any regular interest in another REMIC held by such REMIC is treated as a loan.
1007	GENERAL BUSINESS CREDIT	725	38	N/A	N/A	NOT APPLICABLE - California has never allowed a general business credit.
1007	ALTERNATIVE MINIMUM TAX - ORGANIZATION SUBJECT TO UBI AND EXEMPTION FOR SEPARATE RETURNS	3870	55	17062	23400	TECHNICAL - Reflect change from corporate preference tax to AMT. Previously an entity subject to UBI was subject to preference tax and now is subject to AMT. Also exemption amount modified to address filing of separate return. See also CCH 4300.
1007	ALTERNATIVE MINIMUM TAX CHANGES	4300	56	17062	23400	SUBSTANTIVE - Numerous changes to AMT include clarification of liability, taxable income figure, exemption phase-out, investment interes, loss limitations, possessions tax credit, and tax preferences. Also, standard deduction and pers exemption are denied
1007	MINIMUM TAX PROVISIONS - TAX PREFERENCE ITEMS	4310	57	17062	23457	TECHNICAL - Modifies the timing of the inclusion for Alt Min purposes of the income from exercise of a stock option and requires Estates and Trusts to treat charitable contributions as tax preferences.
1007	DENIAL OF CERTAIN LOSSES FOR ALTERNATIVE MINIMUM TAX	4310	58	17062	23400	TECHNICAL - TAMRA provides that farm tax shelter losses must be adjusted to remove their preference and qualified housing interest may not be include in computing passive business activity losses.
1007	MINIMUM TAX PROVISIONS - LOSS LIMITATIONS AND FOREIGN TAX CREDIT	4300	59	17062	23400	TECHNICAL - When computing AMTI, passive losses used in computing the loss limitations for at-risk purposes must be adjusted to remove their tax preference element. Also clarifies the computation of the foreign tax credit.

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Technical and Miscellaneous Revenue Act of 1988
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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1007 (g)	NONRESIDENT ALIEN SPECIAL RULES	5002	2(d)	17024.5(b)	N/A	NOT APPLICABLE - California has never adopted the federal tax treatment relating to nonresident aliens. This change is simply updating a cross reference relating to regular tax and alternative minimum tax to the sections dealing with nonresident aliens.
1007 (g)	IMPOSITION OF TAX ON CORPORATIONS	5003	11	N/A	23151	NOT APPLICABLE - California corporate tax does not distinguish between domestic and foreign corporations generally but taxes all corporations doing business in the state. TAMRA is simply updating a cross reference to take AMT into account in this sec.
1007 (g)	EARNED INCOME CREDIT	5009	32	N/A	N/A	NOT APPLICABLE - California does not have an earned income credit. This TAMRA change is deleting a redundent phrase.
1007 (g)	PRIOR YEAR MINIMUM TAX CREDIT	745	42	17058	23610.5	NOT APPLICABLE - TAMRA provides that recapture of low income housing credit is not to be treated as regular tax imposed when calculating the minimum tax credit. California has no recapture of low income housing credit provision so change does not apply.
1007 (g)	PRIOR YEAR MINIMUM TAX CREDIT CLARIFIED	785	47	N/A	N/A	NOT APPLICABLE - TAMRA clarifies that investment credit recapture is not to be considered as part of the tax imposed in prior years when calculating the minimum tax credit. California never allowed an investment tax credit so TAMRA change does not apply.
1007 (g)	CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY	5020	53	17063	23453	CLERICAL - Corrects a cross reference description of the method in Sec 56(g) from adjusted "earnings and profits" to adjusted "current earnings".
1007 (g)	CIRCULATION EXPENDITURES	5072	173	17201	24364	CLERICAL - Corrects a cross reference.
1007 (g)	RESEARCH AND EXPERIMENTAL EXPENDITURES	5073	174	17201	24365	CLERICAL - Corrects a cross reference.
1007 (g)	CAPITAL EXPENDITURES	5088	263	17201	24423	CLERICAL - Corrects a cross reference.
1007 (g)	UNRELATED BUSINESS INCOME TAX	3870	511	17651	23731	TECHNICAL - When a tax-exempt is subject to UBI it is also subject to AMT. This change moves the imposition language from Sec. 511(d) to 55(b)(2) and makes clarifying changes.
1007 (g)	DEVELOPMENT EXPENDITURES	5171	616	17681	24831	CLERICAL - Corrects a cross reference.
1007 (g)	DEDUCTION AND RECAPTURE OF CERTAIN MINING EXPLORATION EXPENDITURES	5172	617	17681	24831	CLERICAL - Corrects a cross reference.
1007 (g)	TREATMENT OF S TERMINATION YEAR	5277	1362	N/A	23801	CLERICAL - Corrects a cross reference.
1007 (g)	CORPORATIONS REQUIRED TO PAY ESTIMATED TAX	5387	6154	18682	25561	CLERICAL- Corrects a cross reference.
1007 (g)(1)	DEFINITION OF REGULAR TAX	5006	26	17039	23036	CLERICAL - Makes a punctuation change.
1008 (a)	LIMITATION ON USE OF CASH METHOD	2340	448	17562	24654	TECHNICAL - Clarifies the indirect ownership test for personal service corporations, requires regs relating to related parties used to avoid the rules, rules for affiliated group, predecessor entities and the definition of a tax shelter.
1008 (a)	OIL AND GAS TAX SHELTERS	2355	461	17551	24681	TECHNICAL - Clarifies the economic performance rule and specifies that in partnership tax shelters, the partners's deduction is limited to the partner's cash basis in the partnership and defines cash basis.

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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1008 (a)	LIMITATION ON DEDUCTIONS FOR CERTAIN FARMING EXPENSES	2350	464	17551	24682	TECHNICAL - TAMRA sunsets this section since under the 86 TRA farming syndicates are required to use the accrual method of accounting which automatically prevents the abuse.
1008 (b)	UNIFORM CAPITALIZATION RULES	2215	263A	17201	24422.3	TECHNICAL - Clarifies exception for certain costs, claculation of interest required to be capitalized and allows deduction of certain crop replantings.
1008 (b)	METHOD OF ACCOUNTING FOR CORPORATIONS ENGAGED IN FARMING	5141	447	N/A	24652	CLERICAL - Correct drafting errors in phrasing.
1008 (c)	LONG-TERM CONTRACT LOOK-BACK RULES SIMPLIFIED	2332	460	17551	24673.2	TECHNICAL - Determination of proper cumulative tax on a completed contract are redetermined using actual versus estimated figures. This change specifies the discount rate to be used and exempts certain contracts under $1 million from these rules.
1008 (d)	BAD DEBTS RESERVE	5066	166	17201	24348	CLERICAL - The 86 TRA repealed the reserve for bad debts in Sec. 166(c). TAMRA makes this change to eliminate the cross reference to that repealed section.
1008 (d)	BAD DEBTS, LOSSES AND GAINS WITH RESPECT TO SECURITIES HELD BY FINANCIAL INSTITUTION	5166	582	N/A	N/A	NOT APPLICABLE - Clerical correction to a cross reference.
1008 (e)	PERSONAL SERVICE CORPORATION	2335	441	17551	24631	TECHNICAL - Clarifies the tax year of a personal service corporation and affiliated group rules.
1008 (e)	TAXABLE YEARS OF COMMON TRUST FUNDS	2375	584	17671	N/A	TECHNICAL - TAMRA, consistent with the provisions in the 86 TRA, requires that common trust funds use the calendar year as their tax year. A participant in the fund is required to report the income from the short period ratably over a four year period.
1008 (e)	TAX YEARS OF PARTNERSHIP AND S CORPORATIONS	2280	706	17851	N/A	TECHNICAL - Clarifies the rules for partnership tax years to require the use of a new "majority interest taxable year" definition, authorizes regs relating to the majority interest rule and 86 TRA Act language for required changes in tax years. CCH 2283.
1008 (f)	PROPORTIONATE DISALLOWANCE RULE (PRIOR TO REPEAL BY 87 REVENUE ACT)	2315	453C	17560	24667	TECHNICAL - Clarifies which obligations are "applicable installment obligations", revolving credit plan sales, timing of the application of these rules and losses from sales of receivable arising from revolving credit plans.
1008 (g)	INSTALLMENT METHOD	5144	453	17551	24667	CLERICAL - Corrects a drafting error in phrasing.
1008 (g)	INSTALLMENT METHOD FOR DEALERS IN PERSONAL PROPERTY	5145	453A	17551	24667	CLERICAL - Corrects a cross reference.
1008 (i)	PARTNERSHIP COMPUTATIONS	5179	703	17853	N/A	CLERICAL - Corrects a cross reference.
1008 (j)	LIMITATIONS ON ASSESSMENT AND COLLECTION	5414	6501	18586.6	25663	CLERICAL - Eliminates an obsolete cross reference to a Sec. 118(c) statute extension which was repealed by the 86 TRA.
1009 (a)	LARGE BANK EXCEPTION TO RESERVES FOR LOSSES ON LOANS OF BANKS	5168	585	N/A	24348	NOT APPLICABLE - Makes clarifying changes to the large bank exception to which California has not conformed.
1009 (b)	EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME OF FINANCIAL INSTITUTIONS	3830	265	N/A	24425	NOT APPLICABLE - TAMRA makes technical changes to the exception from deduction denial for certain qualified tax-exempt obligations to which California has not conformed.

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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1009 (b)	SPECIAL RULES RELATING TO CORPORATE PREFERENCE ITEMS	5098	291	N/A	24449	CLERICAL - Corrects a cross reference and internal numbering.
1009 (c)	NET OPERATING LOSS DEDUCTION	5071	172	17276	24416	CLERICAL - Corrects a cross reference, internal numbering and corrects phrasing.
1009 (d)	DEPOSITOR LOSSES FROM INSOLVENT FINANCIAL INSTITUTIONS	485	165(1)	17201	N/A	SUBSTANTIVE - Depositor losses were previously treated as casualty losses deductible only to the extent it exceeds $100 plus 10 percent of AGI. This change allows the up to $20,000 of the loss as a business but is in lieu of any casualty loss deduction.
1009 (d)	GENERAL RULE FOR TAXABLE YEAR OF INCLUSION	5143	451	17551	24661	TECHNICAL - Provides for claims to be filed within one year after TAMRA is enacted (11/10/88) for changes in reporting crop insurance proceeds or proceeds from livestock sold on account of drought for years which would have normally been closed.
1010 (b)	TAX EXEMPT ORGANIZATIONS PROVIDING COMMERCIAL-TYPE INSURANCE	3880	501(m)	N/A	N/A	NOT APPLICABLE - California has not conformed to this federal provision which denies tax exemption to charitable or social organizations if a substantial part of its activity is providing commercial-type insurance. TAMRA changes are thus not applicable.
1010 (f)	INSURANCE COMPANY GROSS INCOME	3535	543	N/A	N/A	NOT APPLICABLE - California imposes a gross premiums tax on insurance companies rather than a tax on or measured by income.
1011	QUALIFICATION OF PENSION PLANS	1210	401	17501	N/A	TECHNICAL - Numerous technical changes are made including nondiscrimination test, coverage and participation rules (CCH 1225), integrated plans (CCH 1230), family member rule (CCH 1445), limit on elective deferrals and other CODA rules(CCH 1570-1576).
1011	ELECTIVE DEFERRAL RULES UNDER CASH OR DEFERRED ARRANGEMENTS (CODAs)	1570	403	17501	N/A	TECHNICAL - Several modifications are made to the rules under the 86 TRA provision imposing an overall limit on elective deferrals including qualification, earnings and distributions, certain govt plans and tax sheltered annuity rules.
1011	DEDUCTIONS FOR PLAN CONTRIBUTIONS	1460	404	17501	N/A	TECHNICAL - Clarifies the rules for the $200,000 compensation limit and the rule for deduction by employer of contributions to a SEP (see CCH 1550).
1011	IRA RULES MODIFIED	1512	408	17501	N/A	TECHNICAL - Several modifications are made to IRA rules including valuation of distributions, contributions withdrawn before and after return due date, info returns for non-deductible IRA contributions, rules for salary reduction SEPs and definitions.
1011 (a)	IRA DEDUCTION LIMIT - MARRIED FILING SEPARATE RETURNS	400	219(g)	17131	N/A	TECHNICAL - Corrects the IRA deduction limit for active participants to take into account the active participant status of both spouses whether separate or joint returns are filed. Rules for separated spouses are also provided.
1011 (b)	INFORMATION RETURNS FOR NONDEDUCTIBLE IRA CONTRIBUTIONS	4730	6693	18681.9	N/A	SUBSTANTIVE - A penalty of $50 is imposed for each failure to file the form prescribed by the IRS (Form 8606) for nondeductible IRA contributions and in the information which may be required on the form, fiscal years are taken into account.
1011 (c)	PENSION TRUST FUNDED BY EMPLOYEE CONTRIBUTIONS	3875	501(c)(18)	N/A	23701s	TECHNICAL - Amends the requirements for tax exemption to include the cap on elective deferrals.

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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1011 (d)	MODIFY LIMITS ON BENEFITS AND CONTRIBUTIONS TO QUALIFIED PLANS	1420	415	17501	N/A	TECHNICAL - Clarifies the rules for limiting benefits for employees with less than 10 years of service, time for electing COLA participation and a rule for computing the combined limit for multiple plans mixing defined benefits with defined contributions
1011 (e)	CLARIFICATION OF RULES FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS	1353	457	17551	N/A	TECHNICAL - Reconciles rules for distributions from gov't plans with rules for tax-exempt entity plans. Clarifies when distributions may begin. Requires regs to be written covering incidental death benefits, constructive receipt rule and amount deferred.
1011 (h)	SANCTIONS ON PENSION PLANS FOR FAILURE TO SATISFY COVERAGE OR 50-40 RULES	1225	402	17504	N/A	TECHNICAL - Modifies provision to apply to failure to satisfy the 50-40 benefit rule as well as failure to satisfy coverage rules. Highly compensated employees must include their vested benefits in income while those employees that are not can exclude.
1011 (h)	MINIMUM COVERAGE REQUIREMENTS FOR EMPLOYERS WHOSE EMPLOYEES ARE ALL HIGHLY COMPENSATED	1215	410	17501	N/A	TECHNICAL - Clarifies that a plan will satisfy the minimum coverage requirements for a plan year when a plan is maintained by an employer having no employees other than highly compensated employees for that year.
1011 (h)	COVERAGE REQUIREMENTS FOR COLLECTIVELY BARGAINED PLANS OF PROFESSIONAL EMPLOYEES	1220	413	17509	N/A	TECHNICAL - Clarifies that when a collectively bargained plan covers multiple employers, the rules for aggregating employees of all employers for purposes of testing for plan discrimination does not include professional employees under the plan.
1011 (i)	LIMITATION ON CONTRIBUTIONS AND BENEFITS OF PENSION PLANS	1435	414	17501	N/A	TECHNICAL - Provides for indexing and other rules in definition of highly compensate employee and regulation authority given for line of business or operating unit rules (See CCH 1440).
1011 (j)	DEFINITIONS AND SPECIAL RULES	1450	414	17501	N/A	TECHNICAL - TAMRA clarifies that this sections definition of compensation applies only is specifically referred to in other Code provisions and coodinates this definition with that in Sec. 415(c)(3).
1011 (j)	TOP HEAVY PLANS - DEFINITION OF KEY EMPLOYEE	1455	416	17501	N/A	TECHNICAL - TAMRA provides that in calculating compensation to determine whether an employee is a "key employee" because of having received annually more than $150,000, the definition to use is in Sec. 415(c)(3) plus elective deferrals.
1011A	EARLY WITHDRAWAL PENALTIES AND LIMITATIONS ON TREATMENT OF TAX FAVORED SAVINGS	1365	72	17085	24272.2	TECHNICAL - Clarifies penalty treatment of QVECs, loans from qualified plans, deferred annuity contracts and IRAs as well as exceptions for equal payments, early retirement and ESOP distributions. Also clarifies the limit on tax-favored savings.
1011A	PROFIT SHARING PLANS	1202	401	17501	N/A	TECHNICAL - In order to distinguish between a profit sharing plan and a money purchase pension plan, TAMRA requires the plan to state which type of plan it is in the manner prescribed by the IRS.
1011A	TREATMENT OF LUMP-SUM DISTRIBUTIONS AND ROLLOVERS	1295	402	17504	N/A	TECHNICAL - Clarifies the definition of rollover contributions to IRAs, special rule for 1987 lump-sum distributions, corrects drafting errors for forward averaging and capital gain, partial distributions, frozen deposits and unrealized appreciation.
1011A	LIMITATIONS ON DEDUCTIONS WHERE COMBINATION OF DEFINED CONT PLAN AND DEFINED BENEFIT PLAN	5121	404	17501	24601	CLERICAL - Corrects drafting errors in phrasing cross referencing.

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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1011A	ROLLOVER FROM QUALIFIED PLAN INTO CONDUIT IRA BY 5% OWNER	1310	408	17501	N/A	TECHNICAL - Clarifies that 5% owners may roll over a qualified plan distribution into a "conduit IRA" and subsequently roll over the amount distributed from the IRA into another qualified plan without adverse tax consequences.
1011A(b)	BASIS RECOVERY RULES FOR EMPLOYEE CONTRIBUTIONS TO DEFINED BENEFIT PLANS	1290	72	17085	N/A	TECHNICAL - Clarifies that employee contributions to a defined benefit which are credited to a seperate account are to be treated as contributions to a defined contribution plan and all basis recovery rules for that type of plan will apply.
1011A(b)	EMPLOYEES OF FOREIGN AFFILIATES	5123	406	17501	24601	CLERICAL - Changes to cross references to take into account the technical corrections made by TAMRA.
1011A(b)	CERTAIN EMPLOYEES OF DOMESTIC SUBSIDIARIES ENGAGED IN BUSINESS OUTSIDE THE U.S.	5124	407	17501	24601	CLERICAL - Change cross references to reflect the technical changes made by TAMRA.
1011A(b)	BASIS RECOVERY RULES FOR EMPLOYEE CONTRIBUTIONS TO A DEFINED BENEFIT PLAN	1285	414	17501	N/A	TECHNICAL - Clarifies that employee contributions to a defined benefit plan which are treated as a separate contract will be treated as a defined contribution plan for purposes of the basis recovery rules upon distribution.
1011A(c)	DEFINITION OF REGULAR TAX	5005	26	17039	23036	CLERICAL - Changes cross references to Sec. 72 and 408(f) to reflect the technical changes made in those sections by TAMRA.
1011A(g)	INCOME IN RESPECT OF DECEDENTS	1345	691	17731	N/A	NOT APPLICABLE - Under TAMRA no deduction will be allowed as IRD for the portion of the federal estate tax increased due to excise tax on excess distributions from qualified retirement plans under Sec. 4980A to which California does not conform.
1011A(g)	INFORMATION RETURN BY EXECUTOR REQUIRED FOR INCREASE IN FEDERAL ESTATE TAX	2585	6018	N/A	N/A	NOT APPLICABLE - TAMRA adds an info reporting requirement on executors who have had to pay the estate-level tax on excess retirement accumulations. California does not conform to the imposition of estate taxes except for the "pick up tax".
1011A(m)	FEDERAL THRIFT SAVINGS FUND	5459	7701(j)	17510	N/A	TECHNICAL - Adds a cross reference to Sec. 401(k) plans as well as Sec. 402(a)(8) plans in 7701(j)(C) which provides that in federal cafeteria plans, the option that the contribution could be received by the employee as cash will not trigger distribution
1011B	DEPENDENT CARE ASSISTANCE	1825	129	17131	N/A	TECHNICAL - Clarifies that the $5,000 maximum exclusion is a yearly limit which applies to the amount the employer is obligated under the plan to pay to the employee for that year. Also a special benefits test is clarified.
1011B	ESOP DIVERSIFICATION	1588	401	17501		TECHNICAL - Clarifies the qualified election period, the period for ESOP diversivication and the effect of diversification distributionsas well as voting rights for employer stock in non-ESOP defined cont plan. See also 1590-95 & 1610.
1011B	DEDUCTION FOR DIVIDENDS ON EMPLOYER STOCK HELD BY ESOP	1645	404(k)	N/A	24603	NOT APPLICABLE - Clarifies the rules for an employer deduction of dividends paid to the ESOP and specifies that the use of dividends to repay acquisition debt is not a prohibited transaction. California specifically does not conform to Sec. 404(k).
1011B	QUALIFICATIONS FOR TAX CREDIT ESOP	1580	409	17501	N/A	NOT APPLICABLE - Makes technical changes to the definition of tax credit ESOP including distribution rules, diversification distributions, participant's rights on ESOP, voting rights of ESOP stock and estate tax deduction. See also CCH

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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1011B	DEFINITIONS AND SPECIAL RULES RELATING TO EMPLOYEE BENEFIT PROVISIONS	5131	414	17501	N/A	CLERICAL - Corrects cross referencing to take into account TAMRA technical corrections.
1011B(a)	NONDISCRIMINATION RULES FOR EMPLOYEE BENEFIT PROVISIONS	1685	89	18081	N/A	TECHNICAL - Clarifies aggregation, benefit testing, sworn statements, family coverage, provides a simplified method of determining highly compensated employees, clarifies the waiting period for excluded employees, modifies sanctions and earned income.
1011B(a)	QUALIFIED TUITION REDUCTIONS	1798	117	17131	N/A	TECHNICAL - TAMRA makes mandatory the exclusion for tuition reductions provided to employees of educational institutions.
1011B(a)	GROUP LEGAL SERVICES PLANS	1805	120	17131	N/A	TECHNICAL - TAMRA makes mandatory for purposes of group legal services plan nondiscrimination tests the exclusion of the same categories of employees that are excluded for purposes of Sec. 89 fringe benefits.
1011B(a)	CAFETERIA PLANS	1810	125	17131	N/A	TECHNICAL - TAMRA amends definition to exclude plan that offers a choice only among nontaxable fringe benefits. Also clarifies qualified benefits, sanctions, limits on certain elections and employees and pre-89 election for dependent care assistance.
1011B(a)	EDUCATIONAL ASSISTANCE PROGRAMS	1795	127	17151	N/A	TECHNICAL - TAMRA makes mandatory the exclusion of the same group of employees as is excluded under Sec. 89 when testing the nondiscrimination requirements of the educational assistance program.
1011B(a)	STATUTORY FRINGE BENEFITS	1790	132	17131	N/A	TECHNICAL - TAMRA provides that the same group of employees excluded under Sec. 89 must be excluded when testing for nondiscrimination of statutory fringe benefit plans.
1011B(a)	ADDITIONAL REQUIREMENTS TO BE MET BY 501(c)(9),(17)or (20) ORGANIZATIONS	5157	505	N/A	23705	TECHNICAL - Clarifies that all employees of these types of plans must make less than $200,000 (as modified for inflation).
1011B(a)	PENALTY FOR FAILURE TO FILE CERTAIN INFORMATION RETURNS	1755	6652	18683	25933	CLERICAL - Makes cross reference change to take into account modifications made by TAMRA.
1011B(b)	HEALTH INSURANCE COSTS OF SELF-EMPLOYED LIMITED	535	162(m)	17201	N/A	TECHNICAL - The 86 TRA allowed 25% of health insurance to be deducted on Sch C as business expense to the extent it does not exceed earned income. TAMRA limits the deduction to the earned income from the business for which the plan is established.
1011B(c)	DEPENDENT CARE ASSISTANCE PAYMENTS REPORTABLE ON FORM W-2	465	6051	U.I.C. DIV. 6	N/A	SUBSTANTIVE - For 1988 and later years, the total amount incurred for dependent care assistance on behalf of an employee under an employer plan must be reported on the employee's W-2. This amount is necessary to calculate the Child Care Credit.
1011B(d)	LODGING FURNISHED BY EDUCATIONAL INSTITUTIONS TO EMPLOYEES	1800	119	17131	N/A	TECHNICAL - Clarifies the timing of making the test of fair-market-value of rent in order to determine whether the employee is allowed an exclusion from income.
1011B(e)	DEFINITION OF EMPLOYEE	5459	7701(a)(20)	17027	N/A	CLERICAL - Corrects phrasing in the definition of employee.

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1011B(f)	MILITARY FRINGE BENEFITS	1830	134	17131	N/A	TECHNICAL - Clarifies that military fringe benefits covered by rule or regulation as well as statute continue to be excluded from gross income. Also clarifies that the personal use of a vehicle cannot be excluded as a military fringe benefit.
1011B(h)	ESOP LOANS	1640	133	17131	N/A	TECHNICAL - TAMRA clarifies the availability of the partial interest exclusion on various types of ESOP loans.
1011B(h)	TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS	5196	852	17145	24412	CLERICAL - Changes the word "paragraph" to "section" in the provision dealing with interest on certain loans used to acquire employer securities.
1012 (aa)	REQUIREMENT TO DISCLOSE TAX TREATY BASED RETURN POSITIONS	4705	6114	N/A	N/A	NOT APPLICABLE - This provision requires positions contrary to tax treatment required by the IRC to be disclosed on the return when that position is based on an income tax treaty.
1012 (aa)	RENUMBER CODE SECTION 6114 TO 6115	4705	6115	N/A	N/A	NOT APPLICABLE - Clerical renumbering of section to accomodate new section dealing with disclosure of treaty-based positions on returns filed.
1012 (aa)	PENALTY IMPOSED FOR FAILURE TO DISCLOSE TREATY BASED RETURN POSITIONS	4705	6712	N/A	N/A	NOT APPLICABLE - Relates to relationship of tax treaties and the IRC.
1012 (aa)	TAX TREATIES	4705	7852	N/A	N/A	NOT APPLICABLE - Modifies the provision relating to the relationship of federal tax treaties and the IRC.
1012 (b)	DEDUCTION FOR CERTAIN FOREIGN DEFERRED COMPENSATION PLANS	5122	404A	17501	24601	CLERICAL - Corrects drafting error relating to regulations.
1012 (bb)	CERTAIN STOCK PURCHASES TREATED AS ASSET ACQUISITIONS	880	338	N/A	24519	NOT APPLICABLE - Coordinates the sourcing rule with the foreign tax credit limitations. California does not allow a foreign tax credit.
1012 (bb)	FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO U.S. SHAREHOLDERS	2800	551	N/A	N/A	NOT APPLICABLE - Modifies rules relating to the flow-thru of undistributed foreign personal holding company income to U.S. shareholders to which California has not conformed. See also CCH 2805.
1012 (bb)	DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY	2810	552	N/A	N/A	NOT APPLICABLE - Modifies definition of dividends, interest and effective date of foreign personal holding company provisions to which California has not conformed.
1012 (bb)	DISCLOSURE OF TAX RETURN INFORMATION TO FOREIGN GOVERNMENTS	4795	6103	19282	26451	NOT APPLICABLE - Clarifies the disclosure of information under bilateral agreements with the foreign government and the U.S. California has its own unique disclosure of information provisions which do not contain foreign government provisions.
1012 (i)	RETURNS AS TO ORG OR REORG OF FOREIGN CORP AND AS TO ACQUISITION OF THEIR STOCK	4780	6046	N/A	N/A	NOT APPLICABLE - Modifies rules relating to captive insurance rules to which California does not conform.
1012 (j)	TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF THE UNITED STATES	2820	901	N/A	N/A	NOT APPLICABLE - Modifies rules for gross up of dividends for foreign tax credit and possessions corporation foreign tax credit to which California has not conformed. See also CCH 2825.
1012 (o)	SPECIAL TAX PROVISIONS FOR U.S. PERSON	3210	6039E	N/A	N/A	NOT APPLICABLE - Clarifies the rules for resident status information upon application for passports. See also CCH 4790.

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1012 (p)	GAIN ON FOREIGN INVESTMENT COMPANY STOCK	5259	1246	17024.5(b)(5)	24990	CLERICAL - Corrects cross reference and internal numbering.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANY WHICH IS ALSO A CONTROLLED FOREIGN CORPORATION	930	1248	17024.5(b)(5)	24990	NOT APPLICABLE - Clarifies that the amount of ordinary income to be reported on the sale of stock when portions of the undistributed earnings have been taxed to the shareholder previously. California has not conformed to tax undistributed earnings.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANIES - NONQUALIFIED FUNDS	925	1291	N/A	24995	NOT APPLICABLE - Modifies the deemed-paid rules and rules for excess distributions to which California specifically does not conform.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANY - SHAREHOLDER INCOME	935	1293	N/A	24995	NOT APPLICABLE - Modifies rules for earnings and profits of qualified electing fund and authorizes regulations in a section to which California specifically does not conform.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANY - EXTENSION OF TIME TO PAY CERTAIN TAXES	940	1294	N/A	24995	NOT APPLICABLE - Clarifies rules with respect to the payment of tax on undistributed earnings to which California specifically does not conform.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANY	930	1295	N/A	24995	NOT APPLICABLE - Modifies the time for making an election under this section to which California specifically does not conform.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANY	920	1296	N/A	24995	NOT APPLICABLE - Modifies the definition of passive income in a section to which California specifically does not conform.
1012 (p)	PASSIVE FOREIGN INVESTMENT COMPANY - ATTRIBUTION OF STOCK OWNERSHIP	945	1297	N/A	24995	NOT APPLICABLE - Modifies attribution rules for stock options and distributions to deemed owners to which California specifically does not conform.
1012 (q)	DEFINITION OF REGULAR TAX MODIFIED TO EXCLUDE BRANCH PROFITS TAX	705	26	17039	23036	NOT APPLICABLE - California does not impose a branch profits tax.
1012 (s)	WITHHOLDING ON FOREIGN PARTNERS' SHARE OF EFFECTIVELY CONNECTED INCOME	4850	1446	18807	N/A	TECHNICAL - Modifies and clarifies the rules for withholding by a U.S. or foreign partnership on amounts allocable to foreign partners of income "effectively connected".
1012 (s)	AMOUNTS TREATED AS OVERPAYMENTS	5407	6401	N/A	N/A	NOT APPLICABLE - Corrects a drafting error in the provision dealing with withholding on nonresident aliens and on foreign corporations.
1012 (t)	COMPENSATION OF EMPLOYEES OF FOREIGN GOVERNMENTS OR INTERNATIONAL ORGANIZATIONS	3010	893	17146	N/A	TECHNICAL - Clarifies that the exclusion from income of wages of an employee of a foreign government does not apply if the employees services are primarily in connection with a commercial activity.
1012 (v)	FOREIGN CURRENCY TRANSACTIONS	3170	988	17078	24905	TECHNICAL - Modifies and clarifies rules relating to foreign currency transactions and futures or option contracts, sourcing rules, measurement and recognition of foreign currency gain or loss and hedging transactions. See also CCH 3175-3185.
1012 (y)	TAX TREATMENT OF RESIDENTS OF U.S. POSSESSIONS	5458	7654	N/A	N/A	NOT APPLICABLE - Clerical correction of drafting error.
1013	TAX-EXEMPT BONDS	3700	103	17143	24272	NOT APPLICABLE - TAMRA makes numerous technical corrections and clarifications to the federal provisions relating to bonds the interest on which is excluded from income under federal law to which California does not conform but uses its own rules.

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Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1013 (a)	SUNSET DATES FOR MORTGAGE CREDIT CERTIFICATES (MCCs)	3730	25	N/A	N/A	NOT APPLICABLE - California does not have a comparable credit.
1013 (a)	SPECIAL RULES FOR GENERAL BUSINESS CREDIT	5017	48	N/A	N/A	NOT APPLICABLE - Corrects a drafting error in special rule for property financed by subsidized energy financing or industrial development bonds. California does not allow a general business credit.
1013 (a)	DECLARATORY JUDGEMENTS RELATING TO STATUS OF CERTAIN GOVERNMENTAL OBLIGATIONS	7478	7478	N/A	N/A	NOT APPLICABLE - Corrects a drafting error in section.
1014 (a)	GRANTOR RETAINED INTEREST TRUSTS	2500	672	17731	N/A	TECHNICAL - TAMRA expands the spousal attribution rule to include spouse who marries a grantor after the creation of the power or interest and for certain situations where spouses are trustees of the trust.
1014 (a)	POWER TO CONTROL BENEFICIAL ENJOYMENT	2500	674	17731	N/A	TECHNICAL - Clarifies that if a spouse is a trustee the grantor can be treated as the owner of the trust under certain conditions.
1014 (a)	ADMINISTRATIVE POWERS - BORROWING OF TRUST FUNDS	2500	675	17731	N/A	TECHNICAL - Clarifies that certain borrowing of trust funds by a spouse can treat the grantor as the owner of the trust and thus taxable on the income from the trust.
1014 (b)	VALUATION OF GRANTOR'S REVERSIONARY INTEREST	2505	673	17331	N/A	TECHNICAL - Clarifies the rule for valuing whether has a 5% or greater reversionary interest (the new test after the 86 TRA repealed the Clifford trust rules).
1014 (c)	BENEFICIARIES OF TRUSTS WHICH CHANGED TO A CALENDAR YEAR	2520	664 *ACT*	17551	N/A	TECHNICAL - Clarifies the four year spread of income from the short period also applies to beneficiaries of a charitable remainder trust. See also CCH 2525.
1014 (d)	MULTIPLE TRUSTS	2510	643	17731	N/A	TECHNICAL - TAMRA clarifies rules regarding aggregation of certain multiple trusts.
1014 (d)	ESTIMATED TAX PAYMENTS BY PRIVATE FOUNDATIONS AND CHARITABLE TRUSTS	2515	6654	18682(h)	N/A	NOT APPLICABLE - Clarifies the rules for estimated tax payments of private foundations and charitable trusts to which California does not conform.
1014 (e)	COORDINATION OF KIDDIE TAX WITH THE TAXATION OF CERTAIN SALES OF TRUST PROPERTY	410	1(i)	17041(g)	N/A	TECHNICAL - Provides the manner in which the gain on the sale of property originally transferred to a trust at less than fair market value is to be calculated. Also clarifies that in joint custody situations the custodial parent's rates are to be used.
1014 (e)	UNEARNED INCOME OF MINOR CHILD SUBJECT TO ALTERNATIVE MINIMUM TAX AT PARENT'S AMT RATE	4320	59	17062	23400	SUBSTANTIVE - For years after 1988, the amount of income that is taxed at a parent's tax rate is now subject to AMT at the parent's AMT rate not to exceed the amount the parent would pay. The amount of income exempt from AMT is earned income + $1,000.
1014 (e)	DISCLOSURE OF INFORMATION TO PERSON HAVING MATERIAL INTEREST	5384	6103	19282	26451	CLERICAL - Corrects a cross reference.
1015 (a)	NOMINEE REPORTING BY PARTNERSHIP CLARIFIED	4740	6724	18681.1	N/A	TECHNICAL - Clarifies that a nominee holding a partnership interest and failing to furnish certain information returns called "payee statements" is subject to the penalty for failure to furnish those statements.

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1015 (b)	NEGLIGENCE OR FRAUD PENALTIES COORDINATED WITH ELECTION TO FILE JOINT RETURN	4710	6013(b)(5)	18410.5	N/A	TECHNICAL - Clarifies that if, after making seperate returns which have been filed negligently or fraudulently, the taxpayers elect to file a joint return, the negligence or fraud penalties will still apply to the original filing.
1015 (b)	EXTENDS INTEREST PERIOD FOR CALCULATING INTEREST ON NEGLIGENCE AND FRAUD PENALTIES	4710	6601	18689	25901c	TECHNICAL - Interest on negligence and fraud penalties is to be calculated from the due date of the return until payment versus from the date of the assessment. The penalty section was modified to eliminate a portion of the penalty relating to interest.
1015 (b)	NEGLIGENCE AND FRAUD PENALTIES MODIFIED	4710	6653	18684	25934	TECHNICAL - Eliminates the portion of the penalty equal to 50% of the interest between return due date and assessment date and instead requires interest to be accrued on the penalty from the return due date. Limits penalty to amount on certain info ret.
1015 (c)	PENALTY FOR SUBSTANTIAL UNDERPAYMENT OF TAX CLARIFIED TO BE 25%	4720	6661	18684.4	25934.4	TECHNICAL - Modifies the effective date of the OBRA of 86 which dealt with Sec. 1504 of the 86 TRA. This eliminates a chaptering problem relating to the amount of the penalty for substantial underpayment of tax being raised to 25%.
1015 (d)	DETERMINATION OF RATE OF INTEREST	5420	6621	19269	25954.2	CLERICAL - Changes the term "short-term Federal rate" to "Federal short-term rate".
1015 (e)	RETURNS OF BROKERS	4750	6045	18802.4	N/A	TECHNICAL - Clarifies the info return requirement with respect to persons who manage a farm on behalf of another person and modifies the real estate reporting requirements to refer to real estate reporting person (formerly known as real estate broker).
1015 (f)	INFORMATION REPORTING ON FEDERAL GOVERNMENT CONTRACTS	4775	6050M	18802.9	N/A	NOT APPLICABLE - Clarifies the exceptions to the reporting by federal agencies to the IRS on government contracts. The California counterpart applies to state contracts with state agencies and is unique to this state.
1015 (g)	INFORMATION REPORTING - FAILURE TO SUPPLY TIN BY DIVIDEND AND ROYALTY PAYEE	4725	6676	18685.07		NOT APPLICABLE - TAMRA clarifies rules relating to the reporting of TIN by dividend and royalty payors to which California has never conformed.
1015 (h)	ESTIMATED TAX OF PRIVATE FOUNDATIONS AND CERTAIN TAX EXEMPT ORGANIZATIONS	715	6154	18682	25561	NOT APPLICABLE - California provisions requiring the payment of estimated tax by corporations is substantially different than federal law. TAMRA changes to the federal provisions do not apply.
1015 (i)	AWARDING OF COURT COSTS AND CERTAIN FEES BY TAX COURT	4865	7430	N/A	N/A	NOT APPLICABLE - Clarifies the procedures and corrects cross reference. California does not have a Tax Court.
1015 (k)	RETIRED PAY OF TAX COURT JUDGES	4880	7447	N/A	N/A	NOT APPLICABLE - TAMRA clarifies the manner in which the federal government is to calculate the retirement pay of Tax Court judges which has no California counterpart.
1015 (l)	SPECIAL PROCEDURES FOR THIRD-PARTY SUMMONSES	5455	7609	18586.7	N/A	TECHNICAL - TAMRA makes technical changes to the duties of summoned parties relating to the suspension of the statute of limitations. California does use summonses but instead may subpoena the records of a third-party recordkeeper.
1015 (m)	STATUTE OF LIMITATION	4890	6212	18587	N/A	TECHNICAL - TAMRA clarifies that if a deficiency notice has held open the statute of limitations and that notice is later suspended, the statute of limitations begins to run again at the date of the recision notice.

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1015 (n)	ABATEMENTS	5409	6404	19131	25801	CLERICAL - Corrects a drafting error.
1015 (o)	PROPERTY EXEMPT FROM LEVY	5404	6334	N/A	N/A	CLERICAL - Corrects cross references.
1015 (q)	GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST	5372	6011	18493	N/A	CLERICAL - Corrects a drafting error.
1015 (r)	CERTAIN REFUNDABLE CREDITS TO BE ASSESSED UNDER DEFICIENCY PROCEDURES	5390	6201	18602	N/A	NOT APPLICABLE - Moves the provision from Sec. 6201 to Sec. 6211 which enables a taxpayer to utilize the protest and appeal procedures on being assessed. California does not have a counterpart to these refundable federal credits.
1015 (r)	CERTAIN REFUNDABLE CREDITS TO BE ASSESSED UNDER DEFICIENCY PROCEDURES	5391	6211	18591.1	25622.1	NOT APPLICABLE - Moves provision from Sec. 6201 to Sec. 6211 thus allowing the taxpayer to utilize the protest and appeal procedures upon being assessed. California does not allow credits comparable to these refundable federal credits.
1015 (r)	PETITION TO TAX COURT	5393	6213	18594	25667	NOT APPLICABLE - California does not allow credits to which this provision relates nor does California have a Tax Court.
1015 (s)	NOTICE OF LIEN ON PERSONAL PROPERTY	5399	6323	N/A	N/A	NOT APPLICABLE - Specifies interaction with a national lien filing system.
1015 (t)	EFFECT OF HONORING LEVY	5403	6332	N/A	N/A	NOT APPLICABLE - Corrects phrasing in this section.
1015 (u)	COLLECTION AFTER COMMENCEMENT OF JUDICIAL PROCEEDINGS	5415	6502	18586.5	25675	TECHNICAL - Clarifies the time in which collection by levy may occur.
1016	TAX-EXEMPT TITLE HOLDING CORPORATIONS	3855	501	N/A	23701u	TECHNICAL - Clarifies the definition of real property, eligible shareholder and their rights for purposes of determining whether the corporation qualifies for tax-exempt status. Also clarifies Sec. 514 provisions relating to UBI of disqualified holders.
1016 (b)	REPEAL OF SECTION 1608 OF THE REFORM ACT RELATING TO A TRANSITION RULE FOR CONTRIBUTIONS	500	1608TRA 86	N/A	N/A	NOT APPLICABLE - Repeals a noncode rule in the 86 TRA to which California never conformed relating to contributions to the Univ of Texas and LSU where athletic tickets were involved. See explanation of Act Sec 6001 for discussion of new code change.
1017	REFUND ON FUELS NOT USED FOR TAXABLE PURPOSES	5413	6427	N/A	N/A	NOT APPLICABLE - Makes clerical and cross reference changes to a section which has no counterpart in the Revenue and Taxation Code sections administered by the Franchise Tax Board.
1017 (a)	TARGETED JOBS CREDIT	5019	51	17053.7	23621	NOT APPLICABLE - Makes a clerical change to a cross reference. California has its own unique targeted jobs credit with provisions which are substantially different than the federal credit.
1017 (b)	PENALTY FOR FAILURE TO GIVE WRITTEN NOTICE TO CERTAIN SELLERS OF DIESEL FUEL	5421	6652(j)	N/A	N/A	NOT APPLICABLE - Corrects a cross reference in a section which has no counterpart in the Revenue and Taxation Code sections administered by the Franchise Tax Board.
1017 (c)	CREDIT FOR CERTAIN USES OF GASOLINE AND SPECIAL FUELS	5010	34	N/A	N/A	NOT APPLICABLE - Corrects a cross reference in a section which has no California counterpart.
1017 (c)	REFUNDS OF GASOLINE USED FOR CERTAIN PURPOSES	5412	6421	N/A	N/A	NOT APPLICABLE - Makes technical and internal numbering changes in a section which has no counterpart in the Revenue and Taxation Code sections administered by the Franchise Tax Board.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1017 (c)	LIMITATION ON CREDIT OR REFUND	5416	6511(h)	N/A	N/A	NOT APPLICABLE - Makes cross reference change to a provision relating to gas tax credits or refunds which have no counterpart in the Revenue and Taxation Code sections administered by the Franchise Tax Board.
1017 (c)	FAILURE TO OBEY SUMMONS	5434	7210	N/A	N/A	NOT APPLICABLE - Makes clerical cross reference correction.
1017 (c)	SERVICE OF SUMMONS	5452	7603	N/A	N/A	NOT APPLICABLE - Makes cross reference correction in a section to which California does not conform.
1017 (c)	ENFORCEMENT OF SUMMONS	5453	7604	N/A	N/A	NOT APPLICABLE - Makes cross reference corrections in a section to which California does not conform.
1017 (c)	TIME AND PLACE OF EXAMINATION IN SUMMONS PROCEEDING	5454	7605	N/A	N/A	NOT APPLICABLE - Makes cross reference corrections in a section to which California does not conform.
1017 (c)	SPECIAL PROCEDURES FOR THIRD-PARTY SUMMONSES	5455	7609	18586.7	N/A	NOT APPLICABLE - Makes cross reference correction in the section dealing with summonses to which California does not conform but California does provide for a subpoena of third-party recordkeepers.
1017 (c)	FEES AND COSTS FOR SUMMONSED WITNESSES	5456	7610	N/A	N/A	NOT APPLICABLE - Makes cross reference correction in a section to which California does not conform.
1018	CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS	5030	72	17085	24272.2	TECHNICAL - Corrects drafting errors and clarifies an exception to required distributions for certain annuity contracts which are qualified funding assets.
1018	DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES TRUST	5121	404	17501	24601	CLERICAL - Corrects a drafting error.
1018	DEFINITIONS AND SPECIAL RULES FOR PURPOSES OF MINIMUM SURVIVOR ANNUITY REQUIREMENTS	5134	417(e)	17501	N/A	CLERICAL - Corrects a drafting error.
1018	TREATMENT OF FUNDED WELFARE BENEFIT PLANS	5135	419(a)	17501	24601	CLERICAL - Corrects a cross reference.
1018 (b)	ACRS TAX-EXEMPT ENTITY LEASING RULES CLARIFIED	1154	168	17250	24349.5	NOT APPLICABLE - California did not generally conform to ACRS depreciation except with respect to certain residential rental property. These retroactive clarifications of ACRS rules are therefore not applicable for California.
1018 (c)	DEFINITIONS AND SPECIAL RULES - MARKET DISCOUNT BONDS	5267	1278	18151	24990	TECHNICAL - Clarifies that the election to include market discount currently will require a basis adjustment and expends the IRS regulatory authority to include bonds the principal of which is paid in 2 or more payments.
1018 (d)	GOLDEN PARACHUTE PAYMENTS	1162	280G	17201	N/A	TECHNICAL - Provisions relating to shareholder approval of the payment have been modified to take into account nonvoting pref. stock, regulations are required and expands the small business exception to include domestic corp with foreign shareholders.
1018 (d)	TAXABILITY OF CORPORATION ON DISTRIBUTION	845	311	N/A	24481	TECHNICAL - Clarifies that except for certain distributions of appreciated property, no gain or loss is recognized to a corporation on a distribution that is not in complete liquidation of stock, rights or property.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1018 (d)	EFFECT OF DISTRIBUTION OF APPRECIATED PROPERTY ON CORPORATE EARNINGS AND PROFITS	840	312	N/A	24484	TECHNICAL - Clarifies that the rules under this section do not apply to a distribution of a corporation's own obligation.
1018 (d)	GAIN OR LOSS RECOGNIZED ON PROPERTY DISTRIBUTED IN COMPLETE LIQUIDATION	5104	336	N/A	24511	CLERICAL - Corrects a reference to an exception for liquidations which are part of a reorganization.
1018 (d)	CERTAIN STOCK PRUCHASES TREATED AS ASSET ACQUISITIONS	5106	338	N/A	24519	CLERICAL - Corrects a cross reference in the anti-avoidance rule to reflect 86 TRA changes to subsection (d).
1018 (d)	TRANSFER TO CONTROLLED CORPORATIONS	805	351	17321	24521	TECHNICAL - Clarifies the treatment of transfers after 6/20/88 to a controlled corporation when such transfer was partially or wholly granted nonrecognition of gain treatment.
1018 (d)	DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION	800	355(c)	N/A	24553	TECHNICAL - Clarifies the taxability of the corporation on distrubution by requiring gain (but not loss) to be recognized by the distrubutor of property other than the stock and securities of a controlled corporation that is not under a plan of reorg.
1018 (d)	BASIS TO DISTRIBUTEES	800	358	17321	24541	TECHNICAL - Clarifies that no gain is recognized on the distribution of qualified property which includes stock, rights, obligations of the distributing corporation or the forgoing items of another corporation which is a party to the reorganization.
1018 (d)	NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS TREATMENT OF DISTRIBUTIONS	800	361	17321	24551	TECHNICAL - Modifies the rules for nonrecognition by a transferor corporation that is a party to a reorganization to apply to stock for property, rules for recognition of gain to the extent of "boot" and that no loss from the reorg exchange is recognized
1018 (f)	DESIGNATED SETTLEMENT FUNDS - YEAR OF DEDUCTION	2360	468B	17515	N/C	TECHNICAL - Clarifies the definition of qualified payment to a designated settlement fund, requires that the establishment of the fund completely extinguish the taxpayer's tort liability and that earnings in the account are subject to current taxation.
1018 (g)	DEFINITION OF RESIDENT ALIEN AND NONRESIDENT ALIEN	5459	7701(b)(5)	17024.5(b)(11	N/A	NOT APPLICABLE - Corrects a cross reference.
1018 (l)	TRANSFERS BETWEEN SPOUSES OR INCIDENT TO DIVORCE	5138	425	17551	N/A	TECHNICAL - Clarifies that the term disposition does not include certain transfers of property between spouses or transfers incident to divorce.
1018 (l)	TRANSFERS TO FORMER SPOUSE WHO IS A NONRESIDENT ALIEN ARE TAXABLE EVENTS	430	1041	17024.5 (b)	N/A	NOT APPLICABLE - California specifically never adopted rules for nonresident aliens. Gain will be taxed on transfers of property between spouses for transfers to a former spouse incident to a divorce when that spouse is a nonresident alien.
1018 (o)	GAIN ON FOREIGN INVESTMENT COMPANY STOCK	5259	1246	17024.5(b)(5)	24990	CLERICAL - Corrects a cross reference.
1018 (o)	PERIOD OF LIMITATIONS FOR MAKING ASSESSMENTS	5395	6229	N/A	N/A	NOT APPLICABLE - Clarifies the ability to extend the statute by agreement between the partner and the Secretary of the Treasury for items which become nonpartnership items. California has not conformed to the administrative proceedings provisions.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1018 (o)	ADDITIONAL ADMINISTRATIVE PROVISIONS RELATING TO PARTNERSHIPS	5396	6230	N/A	N/A	NOT APPLICABLE - Corrects a drafting error.
1018 (p)	TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS	5196	852	17145	24412	CLERICAL - Corrects cross referencing.
1018 (q)	ORPHAN DRUG CREDIT	5007	28	17057	23609.5	CLERICAL - Corrects a cross reference to the Federal Food, Drug, and Cosmetic Act.
1018 (q)	DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS	820	368(a)	N/A	23251	TECHNICAL - Clarifies the qualification for diversification for purposes of the tax-free reorganization rules can be met through stock holdings in a RIC, REIT, or diversified investment company.
1018 (q)	TAX TREATMENT OF STRIPPED BONDS	915	1286	18151	24990	TECHNICAL - Clarifies the rules for determining the amount of original issue discount (OID) that is allocable to bonds which have had their coupons seperately sold (stripped) when the bonds are tax-exempt. See also CCH 3825.
1018 (q)	S CORPORATION DEFINED	5276	1361	N/A	23803	CLERICAL - Corrects cross reference.
1018 (t)	CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS	5036	106	17131	N/A	CLERICAL - Corrects drafting errors.
1018 (t)	CAFETERIA PLANS	1810	125	17131	N/A	TECHNICAL - Clarifies the definition of a cafeteria plan to exclude certain deferred compensation plans of a rural electric cooperative plan.
1018 (t)	TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST	5119	402	17501	N/A	CLERICAL - Corrects internal section numbering and a drafting error.
1018 (t)	INDIVIDUAL RETIREMENT ACCOUNTS	5125	408	17501	N/A	CLERICAL - Corrects a cross reference.
1018 (t)	QUALIFICATIONS FOR TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS	1618	409	17501	N/A	TECHNICAL - Clarifies the voting rights for employer stock in an ESOP relating to the pass-thru of rights on major changes to the corporation (i.e., mergers, etc.).
1018 (t)	MINIMUM VESTING STANDARDS	5128	411	17501	N/A	CLERICAL - Corrects a drafting error relating to restrictions on certain mandatory distributions.
1018 (t)	DEFINITION AND SPECIAL RULES FOR TAX SHELTERED ANNUITIES	1405	414	17501	N/A	TECHNICAL - Clarifies that tax sheltered annuities are subject to the rules for taxation of distributions pursuant to qualified domestic relations orders (QDROs).
1018 (t)	LIMITATIONS ON BENEFITS AND CONTRIBUTION UNDER QUALIFIED PLANS	5132	415(k)	17501	N/A	CLERICAL - Corrects a drafting error in internal numbering of subsection (k).
1018 (t)	QUALIFIED ASSET ACCOUNT LIMITATION ON ADDITIONS TO ACCOUNT	5136	419A	17501	24601	CLERICAL - Corrects a drafting error relating to the special rule for collective bargained and employee pay-all plans.
1018 (t)	UNRELATED BUSINESS TAXABLE INCOME	5159	512	N/A	23732	CLERICAL - Corrects cross referencing.
1018 (t)	SALES OF STOCK TO ESOP OR CERTAIN COOPERATIVES	1584	1042	18042	N/A	TECHNICAL - Clarifies the nonrecognition of gain on sale of employer securities to ESOP or worker-owned cooperative, determining whether a participant is a 25% shareholder and corrects cross references and drafting errors.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1018 (u)	GENERATION SKIPPING TRANSFER TAX	5064	164	17201	24345	CLERICAL - Corrects a drafting error in the provision which denies a deduction as a tax for the GST tax imposed on income distributions.
1018 (u)	RECAPTURE OF EXCESS DEPRECIATION ON LISTED PROPERTY	5095	280F	17201	24349.1	CLERICAL - Corrects drafting error in reference.
1018 (u)	DEFINITION OF RELATED PERSON FOR INSTALLMENT SALE PURPOSES	5144	453	17551	24667	CLERICAL - Corrects grammer of subsection (f).
1018 (u)	TAX-EXEMPT CORPORATIONS	5156	501	N/A	23706	CLERICAL - Corrects capitalization at the beginning of the sentences of paragraphs (c)(1) and (23).
1018 (u)	TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES	5200	857	17740	24413	CLERICAL - Makes grammatical change in definition of capital gain dividend.
1018 (u)	ADJUSTMENTS TO BASIS	5246	1016	18036	24916	CLERICAL - Eliminates cross reference to obsolete section, renumbers subsection (a) and corrects a cross reference in (a)(24).
1018 (u)	DISPOSITION GAIN REPRESENTING ACCRUED MARKET DISCOUNT TREATED AS ORDINARY INCOME	5265	1276	18151	24990	CLERICAL - Corrects drafting errors in internal section numbering and punctuation.
1018 (u)	DEFERRAL OF INTEREST DEDUCTION ALLOCABLE TO ACCRUED MARKET DISCOUNT	5266	1277	18151	24990	CLERICAL - Corrects punctuation.
1018 (u)	PASSIVE FOREIGN INVESTMENT COMPANY	5274	1296	N/A	N/A	NOT APPLICABLE - Clerical punctuation change.
1018 (u)	RECEIPTS FOR EMPLOYEES (W-2)	5383	6051	N/A	N/A	NOT APPLICABLE - Corrects punctuation.
1018 (u)	STATUTE OF LIMITATION ON CLAIM FOR REFUND OR CREDIT FOR TAX ON PRIVATE FOUNDATIONS	5416	6511(f)	19053	26073	NOT APPLICABLE - California does not impose an excise tax on private foundations.
1018 (u)	SANCTIONS ON WELFARE BENEFIT FUNDS	1755	6652	18683	25933	NOT APPLICABLE - This TAMRA provision states that the excise tax on employers having a discriminatory employee benefit plan is in addition to any other tax imposed. California has not conformed to the imposition of these excise taxes.
1018 (u)	TAX INCENTIVES RELATING TO MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS	5447	7518	N/A	N/A	NOT APPLICABLE - Corrects a cross reference in a section to which California does not conform.
1018 (u)	RESTRICTIONS ON CHURCH TAX INQUIRIES AND EXAMINATIONS	5457	7611	N/A	N/A	NOT APPLICABLE - Corrects a drafting error in a section to which California does not conform.
1018 (u)	DETERMINATION OF MARITAL STATUS	5462	7703(b)	17021.5	N/A	CLERICAL - Corrects a cross reference to the definition of the principal place of abode of a child within this definition.
1018 (u)	TREATMENT OF LOANS WITH BELOW-MARKET INTEREST RATES	5468	7872	17024.5(a)(3)	24993	CLERICAL - Corrects internal section numbering.
1019	ESTIMATED TAX PENALTIES WAIVED	720	6655 *ACT*	N/A	25951	SUBSTANTIVE - For corporations or other taxpayers subject to Sec. 6655 penalties for underpayment of estimated tax will be waived with respect to any period before 4/16/89 to the extent the underpayments was the result of Titles I & II of TAMRA.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
1019 (b)	WAIVER OF ESTIMATED TAX PENALTIES	442	6654 *ACT*	18682	25954	SUBSTANTIVE - A noncode provision which waives the penalty for underpayment of estimated tax due before 4/16/89 to the extent the result of Title I or Title II of TAMRA.
2001 (c)	ADJUSTMENTS IN COMPUTING ALTERNATIVE MINIMUM TAXABLE INCOME	5022	56(f)(2)(B	N/A	N/A	NOT APPLICABLE - TAMRA provides that the environmental tax paid by corporations is not an adjustment for purposes of determining the alternative minimum taxable income of a corporation. California does not impose an environmental tax.
2001 (c)	ENVIRONMENTAL TAX IMPOSED BY SUPERFUND REVENUE ACT OF 1986 DOES NOT APPLY TO RIC OR REIT	4525	59A	N/A	N/A	NOT APPLICABLE - California does not impose an excise tax on corporations called an environmental tax. The federal provision provides a funding mechanism for environmental clean up under the Superfund Revenue Act.
2001 (d)	LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAX	4400	6416	N/A	N/A	NOT APPLICABLE - The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not contain any provisions imposing excise taxes on diesel fuel.
2001 (d)	LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAX	4400	6421	N/A	N/A	NOT APPLICABLE - The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not contain any provisions imposing an excise tax on gasoline.
2001 (d)	LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAX	4400	6427	N/A	N/A	NOT APPLICABLE - The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not contain any provisions imposing an excise tax on fuels.
2003 (a)	TAX EXEMPT STATUS OF RURAL MUTUAL OR COOPERATIVE TELEPHONE AND ELECTRIC COMPANIES	3865	501(c)(12)	N/A	N/A	NOT APPLICABLE - California has never enacted a counterpart to Sec. 501(c)(12) which grants tax exempt status to benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies or like organizations
2004 (a)	DEFINITION OF INTEREST AND SPECIAL RULES	5063	163	17201	24344	CLERICAL - Redenumbers paragraph (h)(6) to (h)(5).
2004 (b)	DEFINITION OF QUALIFIED HOUSING INTEREST FOR PURPOSES OF THE ALTERNATIVE MINIMUM TAX	5022	56	17062	23400	NOT APPLICABLE - California has not conformed to the changes made in the definition of qualified residence interest deductible for purposes of the regular tax made by the 1987 Revenue Act to which these TAMRA technical changes relate.
2004 (d)	INSTALLMENT SALES - TREATMENT OF SALES BY DEALERS	2285	453	17551	24687	NOT APPLICABLE - California has not conformed to the 1987 Revenue Act provisions to which the TAMRA technical changes relate.
2004 (d)	INSTALLMENT SALES BY NONDEALERS OF REAL PROPERTY	2290	453A	17551	24667	NOT APPLICABLE - California has not conformed with the changes made by the 1987 Revenue Act relating to installment sales of real property by nondealers and the repeal of the proportionate disallowance rules.
2004 (e)	LIMITATION ON AMOUNTS PAID BY PERSONAL SERVICE CORPORATIONS TO EMPLOYEE-OWNERS	5097	280H	N/A	N/A	NOT APPLICABLE - California has not conformed to the enactment of these limitations which apply when the personal service corporation elects a tax year other than the calendar year. TAMRA technical changes are therefore not applicable.
2004 (e)	TIERED STRUCTURE RULES RELATING TO ELECTION OF TAX YEAR OTHER THAN CALENDER YEAR	2270	444	17551	24637	TECHNICAL - Under 87 Revenue Act the election of fiscal year can not be made if the pass-thru entity is part of a tiered structure. TAMRA clarifies the rules relating to FY termination upon becoming part of a tiered structure and other related rules.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
2004 (e)	REQUIRED PAYMENTS FOR TAXPAYERS ELECTING YEAR OTHER THAN CALENDAR YEAR	2275	7519	N/A	N/A	NOT APPLICABLE - California did not conform to the requirement for making payments for the election of a tax year other than a calendar year.
2004 (f)	PUBLICLY TRADED PARTNERSHIPS TREATED AS CORPORATIONS	1166	7704	N/A	N/A	NOT APPLICABLE - California has not conformed to the 1987 Revenue Act provision which treats certain publicly traded partnerships as corporations and not as partnerships. TAMRA technical changes are therefore not applicable.
2004 (g)	PASSIVE LOSS RULES - DISPOSITION OF INTEREST IN PUBLICLY TRADED PARTNERSHIP	2245	469	17561(d)	24692(e)	TECHNICAL - Codifies legislative history dealing with suspended losses from publicly traded partnership provisions to which California conformed stating that suspended losses may not be deducted until the taxpayer disposes of their entire interest.
2004 (h)	PARTNERSHIP ALLOCATIONS - DEBT FINANCED REAL PROPERTY	3860	514	N/A	23735	SUBSTANTIVE - Income from debt-financed property is treated as UBTI to tax-exempt partners. Exceptions are made when all partners are tax-exempt. Also, regulations are to deal with the interaction of these rules and rules for substantial economic effect.
2004 (j)	REDEMPTIONS RECEIVED AS DISTRIBUTIONS BY 20 PERCENT CORPORATE SHAREHOLDER	5099	301(e)	17321	24454.2	TECHNICAL - Clarifies that income (and basis of stock in the distributing corporation) of 20 percent corporate shareholders includes redemptions by the distributing corporation of its stock.
2004 (k)	REDEMPTION THROUGH USE OF RELATED CORPORATIONS	5100	304	17321	24457	TECHNICAL - Corrects the word "of" to "from" in the provision relating to the treatment of certain intragroup transactions.
2004 (k)	REDUCE TAX AVOIDANCE ON DISTRIBUTION OF STOCK AND SECURITIES BY A CONTROLLED CORPORATION	810	355(b)	17321	24533	TECHNICAL - Clarifies the section to provide that nonrecognition of gain will not apply for certain corporate spin-off distributions of stock and securities within 5 years of having acquired control of the controlled corporation.
2004 (l)	ALTERNATIVE TAX FOR CORPORATIONS	5255	1201	N/A	24990.5 (a)	NOT APPLICABLE - Makes technical cross reference change to the section dealing with the federal alternative tax for corporations to which California does not conform.
2004 (m)	CORPORATE ACQUISITIONS - LIMITS USE OF PRE-ACQUISITION LOSSES TO OFFSET GAINS	1080	384	N/A	24594	SUBSTANTIVE - Rules limiting an acquiring corporation's use of its pre-acquision losses against the acquired corporation's net built-in gains are broadened to apply as well when the acquiring corp has built-in gains and the acquired corporation had loss.
2004 (n)	RECAPTURE OF LIFO AMOUNT UPON S ELECTION BY MEMBER OF AFFILIATED GROUP	985	1363	N/A	23802	TECHNICAL - Clarifies that a C corporation which was a member of an affiliated group using the LIFO method that subsequently elects S status is the only corporation subject to the recapture rule and not the affiliated group as a whole.
2004 (r)	ESTIMATED TAX OF PRIVATE FOUNDATIONS AND CERTAIN TAX EXEMPT ORGANIZATIONS	715	6655	N/A	25951	NOT APPLICABLE - California did not conform to the substantial changes made to corporate estimated tax provisions by the 1987 Revenue Act.
2004 (s)	LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAX	4405	6427	N/A	N/A	NOT APPLICABLE - The provisions of the Revenue and Taxation Code administered by the Franchise Tax Board do not contain any provisions imposing a tax on aviation fuel.
2005	LIMITATIONS ON CONTRIBUTIONS AND BENEFITS OF PENSION PLANS	1465	404	17501	24601	TECHNICAL - Modifies the rules for aggregation of plans maintained by more than one employer, the overall deduction limit is conformed to the rule allowing deductions up to the unfunded current liab, and deletes an obsolete part of the funding standards.

APPENDIX II

Technical and Miscellaneous Revenue Act of 1988
Titles I and II (Technical Corrections)

Act Section	Subject	CCH Para	IRC Sec.	PIT Sec.	B&C Sec.	Explanation
2005	MINIMUM FUNDING STANDARDS FOR COLLECTIVELY BARGAINED PLANS	5129	412	17501	N/A	TECHNICAL - Corrects the date beginning dates contained in the section.
2005	PENSION PLAN DEFINITION AND RULES	1355	414	17501	N/A	TECHNICAL - Provides that excess plan assets are to be allocated proportionately among the plans that have been spun-off within a controlled group of corporations. Rules are provided for situations involving corporations not originally part of the plan.