State of California
Franchise Tax Board

SUMMARY OF FEDERAL INCOME TAX CHANGES — 1989

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

1989

Prepared by Staff of the

FRANCHISE TAX BOARD

State of California

April 6, 1990

Members of the Board:

State Controller
Chairman, State Board of Equalization
Director of Finance

Executive Officer: Gerald H. Goldberg

SUMMARY OF FEDERAL INCOME TAX CHANGES - 1989

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N/A - Not applicable for state purposes.
EDD - Employment Development Department

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Executive Summary

On December 19, 1989, the President signed into law the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239) which included the Revenue Reconciliation Act of 1989 (RRA).

The RRA modified and extended expiring tax provisions relating to:

- o Employer-provided educational assistance.
- o Employer-provided group legal services.
- o Partial deduction of health insurance costs by self-employed individuals.
- o Tax credits for targeted jobs, low-income housing, research expenses, and solar, geothermal, and ocean thermal property.

With respect to corporations, the RRA modified and strengthened limitations on built-in losses, interest paid to related persons, high yield original issue discount obligations, and employee stock option programs. It also made substantial modifications to the adjusted current earnings preference adjustment for purposes of the alternative minimum tax and repealed the completed contract method of accounting.

The RRA restructured and consolidated numerous penalty provisions in order to simplify the law, eliminate overlapping penalties, and encourage voluntary compliance.

The RRA modified rules relating to depreciation and amortization of business assets and increased limitations on investment oriented life insurance contracts. It also made numerous technical amendments to prior acts.

This report also contains changes in federal income tax laws made by the following acts:

- o P.L. 101-73 Financial Institution Reform, Recovery, and Enforcement Act of 1989
- o P.L. 101-140 Repeal of Section 89 Nondiscrimination Rules
- o P.L. 101-179 Support for East European Democracy Act of 1989
- o P.L. 101-194 Ethics Reform Act of 1989

REVENUE RECONCILIATION ACT OF 1989

TITLE VIA: MEDICARE, ETC., TECHNICAL AND MISCELLANEOUS PROVISIONS

ACTION: REPEAL DENIAL OF DEDUCTION FOR GROUP HEALTH PLANS

ACT SECTION: 6202(b)(3)

PRIOR FEDERAL LAW (IRC Sec. 162(i)

Deductions for expenses paid by a group health plan were not allowed if the health plan discriminated against individual having end stage renal disease (kidney disorder).

CURRENT CALIFORNIA LAW (Sec. 17201, 24343)

California law conforms to federal law by reference.

NEW FEDERAL LAW (None)

The prior federal law was repealed thus allowing an employer to deduct expenses for health plans without respect to coverage of treatment for renal dialysis.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Effective for services furnished after November 21, 1989.

IMPACT ON CALIFORNIA REVENUE

Negligible annual revenue loss.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSION OF EXPIRING TAX PROVISIONS

ACTION: EXTENSION OF THE EXCLUSION FOR EMPLOYER PROVIDED EDUCATIONAL ASSISTANCE

ACT SECTION: 7101

PRIOR FEDERAL LAW (IRC Sec. 127(d))

Present law provided that employer provided educational assistance was excludable from an employee's gross income for income and employment tax purposes. The amount of the exclusion was limited to $5,250 per year and did not apply to graduate level courses. This exclusion expired for taxable years beginning after December 31, 1988.

CURRENT CALIFORNIA LAW (Sec. 17131, 17151)

California law is conformed to federal law by reference.

NEW FEDERAL LAW (IRC Sec. 127(d), 132(h)(9))

The new federal law extends the exclusion for educational assistance to expire after September 30, 1990 and retroactively restores the exclusion to December 31, 1988. The prior law dollar limit and graduate level course restriction continue to apply. In addition, the new federal law clarifies the treatment of educational assistance under the working condition fringe benefit rules (Sec. 132(h)(9)).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for taxable years beginning on or after January 1, 1989, for amounts paid prior to October 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Employers have received both federal and state extensions previously and, therefore are accustomed to reporting the same way for state purposes in anticipation of continued conformity. Any revenue losses attributed to employers that do not apply exclusions for 1989 and 1990 for state purposes would most likely be negligible.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSION OF EXPIRING TAX PROVISIONS

ACTION: EXTENSION OF THE EXCLUSION FOR EMPLOYER PROVIDED GROUP LEGAL SERVICES

ACT SECTION: 7102

PRIOR FEDERAL LAW (IRC Sec. 120(e))

Under federal law, amounts contributed by an employer to a qualified group legal services plan for an employee were excluded from the employee's gross income for income and employment tax purposes. The exclusion also applied to amounts paid to an employee as reimbursement for the cost of a qualified legal plan. The maximum amount that could be excluded from gross income was $70 per year. The exclusion for group legal services benefits expired for taxable years ending after December 31, 1988.

CURRENT CALIFORNIA LAW (Sec. 17131, 17157)

California Law is conformed to federal law by reference.

NEW FEDERAL LAW (IRC Sec. 120(e))

Under the new federal law, the exclusion for employer provided group legal services is retroactively reinstated and extended to expire after September 30, 1990.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for group legal services provided in taxable years beginning on or after January 1, 1989, for amounts paid prior to October 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Employers have received both federal and state extensions previously and, therefore, are accustomed to reporting the same way for state purposes in anticipation of continued conformity. Any revenue losses attributed to employers that do not apply exclusions for 1989 and 1990 for state purposes would most likely be negligible.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSION OF EXPIRING TAX PROVISIONS

ACTION: EXTENSION AND MODIFICATION OF DEDUCTION FOR HEALTH INSURANCE EXPENSES OF SELF-EMPLOYED INDIVIDUALS

ACT SECTION: 7107

PRIOR FEDERAL LAW (IRC Sec. 162(1))

Under federal law, a self-employed individual may deduct 25 percent of the health insurance expenses of the individual and the individual's spouse and dependents. In addition, a shareholder with more than a 2 percent equity of an S corporation is for purposes of the employee fringe benefits, treated the same as a partner in a partnership. The deduction is set to expire for years after December 31, 1989.

CURRENT CALIFORNIA LAW (Sec. 17201)

California law is conformed to federal law by reference.

NEW FEDERAL LAW (IRC Sec. 162(1))

The new federal law provides for the 25 percent deduction for health insurance expenses of self-employed individuals to be extended for nine months and to expire after September 30, 1990.

In addition, the amount of earned income for an individual for the portion of the 1990 tax year ending October 1, 1990, shall be determined on a pro rata basis. The Treasury Department is authorized to provide rules for applying the deduction in the case of more than 2 percent shareholders of S corporations.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for taxable years beginning after December 31, 1989. Only expenses for periods on or before September 30, 1990, are to be taken into account in determining the amount deductible.

IMPACT ON CALIFORNIA REVENUE

Since California law has been in conformity with federal law, this extension is probably being applied de facto for state purposes as well. The revenue loss attributed to those taxpayers not reporting the deduction for state purposes in 1990 would most likely be minor, in the $1-2 million range.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: EXTEND AUTHORITY TO ALLOCATE FEDERAL LOW INCOME HOUSING CREDIT BEYOND 1989

ACT SECTION: 7108(a)

BACKGROUND

With regard to the federal credit, a report dated January 1989 from the Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit evaluated the federal credit and recommended the extension of the credit as well as a series of structural changes which would improve both the utilization of the credit as well as the administration of the credit by credit allocating agency in a state. In California the Mortgage Bond and Tax Credit Allocation Committee is responsible for allocating both the federal and the California Low-Income Housing Credits.

PRIOR FEDERAL LAW

Authority to allocate low-income housing tax credits expired December 31, 1989.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

In 1989 the California Low-Income housing provision was modified (by SB 726 and SB 1290) to provide that allocations of state credit amounts after December 31, 1989, would be allowed to be made for as long as similar provisions under federal laws are in effect. Thus, the one year extension of the authority under federal law by the 1989 Omnibus Budget Reconciliation Act (OBRA) automatically extended the authority of the Mortgage Bond and Tax Credit Allocation Committee to allocate $35 million of state low-income housing credits to housing sponsors in 1990.

NEW FEDERAL LAW (IRC Sec. 42(n))

The conference agreement extends the credit for one year (through December 31, 1990); however the State housing credit ceiling applicable to any State is reduced to an amount equal to $0.9375 multiplied by the State population. Also, the credit is allowed to be claimed for eligible property financed with tax-exempt bonds provided that:

(i) the property so financed is placed in service within two years after the bonds are issued; and

(ii) at least ten percent of the estimated project costs are incurred by the close of the calendar year in which the bonds are issued.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

Not applicable. California's Low-Income Housing Tax Credit has been automatically extended by the extension of federal law.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT: ALLOWS ONE YEAR CARRYOVER OF UNUSED CREDIT AUTHORITY

ACT SECTION: 7108(b)

PRIOR FEDERAL LAW

Unused credit authority may not be carried forward, nor may one State's credit authority be made available for projects in another State.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that, to ensure full use of available Credit authority, states be allowed to carryforward any unused State allocation for one year, with any credit that is not used at the end of the carryforward year going to a national pool for reallocation.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

The portion of the aggregate housing credit dollar amount which is not allocated for each year may be carried over to any subsequent calendar years through 1989. A special rule provided (for 1989) that the $35 million credit cap for any year could be exceeded by the amount carried over into 1989 from unallocated credit authority from 1987 and 1988. No carryforward is allowed for unallocated credit authority for 1989 or later years.

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

The Act allows a one-year carryforward of unused credit authority by allocating agencies.

In addition, it increases an allocating agency's credit volume cap by the amount of credit previously allocated to a project that does not become a qualified low-income housing project within specified time limits. Also, any authority unused, by the allocating agency, after the one-year carryforward provided in the Act, is reallocated to other States through a national pool of unused authority. The conference report indicates that Congress intends that State housing credit allocations are made to projects only when there is a reasonable expectation that the project will be placed in service within the required time period.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

Not applicable.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT: ALLOWS CREDIT FOR ACQUISITION OF EXISTING BUILDING ONLY IF IT IS SUBSTANTIALLY REHABILITATED

ACT SECTION: 7108(d)

PRIOR FEDERAL LAW

A 70 percent present value credit may be claimed for the taxpayer's basis in both (1) new construction and (2) qualified substantial rehabilitation expenditures, provided that the property is not federally subsidized.

MINIMUM QUALIFYING EXPENDITURES

To qualify as substantial rehabilitation, qualifying expenditures must average at least $2,000 of qualified basis per low-income unit, but need not be made on the low-income units. Expenses may be incurred over a 24-month period.

A 30 percent present value credit may be claimed for the taxpayer's basis in qualified acquisition property. To qualify for the acquisition credit, substantial rehabilitation need not be undertaken. The 30 percent credit is also available to federally subsidized buildings.

REASON FOR CHANGE

The conference report indicates that Congress intends that no credit be allocated to an existing building which is not in need of substantial rehabilitation.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

The California Low-Income Housing Tax Credit is equal to 30 percent of the qualified basis of each qualified low-income housing building and is taken over a 4 year period. The rules for determining eligible basis for the California credit are identical to the federal rules prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(d))

The Act provides that no credit is allowed for acquired properties (i.e., existing buildings) unless substantial rehabilitation is done. If there is substantial rehabilitation, then all rehabilitation expenditures qualify for a 70 percent credit, and other eligible acquisition costs qualify for a 30 percent credit.

REVENUE RECONCILIATION ACT OF 1989

MINIMUM QUALIFYING EXPENDITURE

Increases the minimum qualifying expenditure for substantial rehabilitation from $2,000 of qualified basis per low-income unit to the greater of:

$3,000 of qualified basis per low-income unit; or

10% of unadjusted basis.

In addition, the rehabilitation expenditures must be on the low-income units or common areas substantially benefiting them.

Credit periods for existing buildings do not begin before the first taxable year of the credit period for the rehabilitation expenditure.

SPECIAL RULES FOR GOVERNMENT OWNED BUILDINGS

Buildings which were owned by, or on behalf of, a governmental unit may continue to qualify for the 30 percent present value credit on both qualified acquisition property and rehabilitation expenses if rehabilitation expenditures average at least $3,000 of qualified basis per low-income unit.

Alternatively, these properties will be eligible for the 70 percent present value credit on rehabilitation expenses, if they satisfy the $3,000/10 percent rule.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT: RENT RESTRICTION RULES CHANGED

ACT SECTION: 7108(e)

PRIOR FEDERAL LAW

BASIS OF DETERMINING RENT RESTRICTION

Maximum allowable rents for rent-restricted units are determined by 30 percent of qualifying income limitation adjusted for family size.

RENT FLOORS

For rent-restricted units, the rent is determined by taking 30 percent of the qualifying income limitation. Annually, as the qualifying income limitation changes, the allowable rent may change.

LOW INCOME TENANTS WHOSE INCOMES RISE

A tenant who qualified for a rent-restricted unit may continue to be deemed to qualify even if his or her income grows to as much as 140 percent of the qualifying income limitation. When the income of a tenant in a qualified rent restricted unit exceeds 140 percent of the qualifying income limitation that unit ceases to be a qualified low-income unit and the rent restrictions under the credit no longer apply. The maximum allowable rent on rent restricted units is determined by 30 percent of the qualifying income limitation.

GROSS INCOME

Section 7872 of the Internal Revenue Code recharacterizes certain loans with below-market interest rates for Federal income tax purposes. A certain noninterest bearing deposit by a tenant with a continuing care facility generally would be, but for an exception to Section 7872, treated by the tenant as a debt obligation on which the tenant receives taxable interest income. This treatment as income has the possibility of making certain residential rental projects financed with exempt bonds (exempt facility bonds) ineligible for such financing since one of the criteria is the income level of the tenants of the housing.

REVENUE RECONCILIATION ACT OF 1989

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California is conformed to the rules relating to rent restrictions. California does not utilize the federal rules to determine whether bonds are tax-exempt or taxable. Under state law, interest on any bond issued by California or a municipality within the state is exempt from California income tax without regard to federal rules for private activity bonds or facility bonds.

NEW FEDERAL LAW (IRC Sec. 42(g), 142(d))

BASIS OF DETERMINING RENT RESTRICTION

The Act uses apartment size rather than family size of occupants for determination of gross rent limitation. Also, actual family size is used as the basis for determination of qualification as a low-income tenant.

RENT FLOORS

The Act sets the initial monthly rental payment as the minimum rental payment for the compliance period at the owner's option.

LOW INCOME TENANTS WHOSE INCOMES RISE

The Act provides that when the income of the tenants in a qualified rent-restricted unit exceeds 140 percent of the qualifying income limitation, the next available unit in the building of comparable size or smaller must be occupied by a new resident who meets the applicable income test or else the old tenants unit ceases to be a qualified low-income unit and the rent restriction under the credit will cease. If the next available unit is occupied by a new resident who meets the applicable income test then the old tenant's unit will continue to be a qualified low-income unit with the rent restriction under the credit continuing to apply until the tenant vacates the unit.

The maximum allowable rent on rent-restricted units is determined by 30 percent of the imputed income limitation applicable to such unit.

GROSS INCOME

The Act provides that income excluded under the special exception to the below-market rate interest rules for deposits in qualified continuing care facilities is to be taken into account in determining the income of the tenant for purposes of the income eligibility rules of the low-income housing credit.

In addition, the Act specifies that a reduction in the median income of an area will not require the reduction of rent in order for the building to remain qualified.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

Not applicable.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; ADDITIONAL BUILDINGS ELIGIBLE FOR WAIVER OF 10-YEAR REQUIREMENT

ACT SECTION: 7108(f)

PRIOR FEDERAL LAW

Generally, properties placed in service within the last 10 years are ineligible for the credit.

Exceptions are provided for buildings transferred in which the new owner retains the basis of the previous owner. When the transferor is a qualified tax exempt organization or a governmental entity, the 10-year rule is applied by looking to the placed-in-service date of the most recent taxable owner.

In addition, exceptions to the 10-year rule are provided (Sec. 42(d)) for certain federally assisted properties, a default on which would result in a Federal Government budget outlay.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit found that one of the most pressing housing problems facing the nation is the impending loss of significant portions of the assisted low-income inventory either through expiring subsidies or the opportunity of owners to convert the project to market-rate use. It recommended that, in order to mitigate this problem, the credit should be amended to allow a waiver from the 10 year holding period for any project (whether or not Federally assisted) that is occupied by lower income families if a sale using the Credit would prevent a default or conversion to market rate use.

CURRENT CALIFORNIA LAW (Sec. 17058, 3610.5)

California is conformed with federal law prior to the 1989 OBRA change.

NEW FEDERAL LAW (IRC Sec. 42(d))

The Act grants two new exceptions from the 10-year rule:

(1) for low-income buildings the mortgages on which are subject to prepayment if the exception is necessary to avert conversion of the properties to market rate use; and

(2) for certain buildings acquired from failed financial institutions.

The conference report indicates that the Resolution Trust Corporation may satisfy the conservator or receiver requirement in the conference agreement.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME TAX CREDIT; INCREASES CREDIT FOR BUILDINGS IN HIGH COST AREAS

ACT SECTION: 7108(g)

PRIOR FEDERAL LAW

A maximum 70 percent present value credit is available for new construction and substantial rehabilitation expenditures while a maximum 30 percent present value credit is available for new federally subsidized buildings and acquisition of existing buildings without substantial rehabilitation.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended allowing greater discretion in setting the Credit Rate in order to facilitate optimum use of the credit and ensure an appropriate credit based subsidy for each project. This would include allowing a credit greater than the normal 70 percent maximum credit in order to make the program viable in high cost areas.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

A maximum 30 percent credit is available for both new construction (whether federally subsidized or not) and acquisition of existing buildings (whether or not undergoing substantial rehabilitation).

NEW FEDERAL LAW (IRC Sec. 42(d))

The Act permits the State allocating agency to increase the maximum credit (up to 91 percent present value) available for buildings in certain high cost areas. In addition, the Act extends the Secretary of HUD's authority to designate, as difficult to develop areas, certain qualified census tracts. Within such qualified census tracts, the eligible basis of a new building or the eligible basis of rehabilitation expenditures in the case of an existing building undergoing substantial rehabilitation is deemed to be 130 percent of eligible basis claimed for depreciation, as is the case for high cost areas.

A qualified census tract is any census tract of a metropolitan statistical area in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income. No more than 20 percent of the population of a metropolitan statistical area may be designated as satisfying the requirements of a qualified census tract.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; CHANGES IN RULES FOR BUILDINGS FOR WHICH CREDIT MAY BE ALLOWED

ACT SECTION: 7108(h)

PRIOR FEDERAL LAW

SPECIAL NEEDS HOUSING

Nonhousing services may be provided to tenants in rent-restricted units on an optional basis. If such services are mandatory and paid for by the tenant, charges for them are deemed added to rental charges and are subject to the 30 percent gross rent restriction.

SCATTERED SITE PROJECTS

All units in a project must be located on contiguous geographic sites.

OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS

Owner-occupied buildings with four or fewer units are ineligible for the credit.

INTERACTION OF CREDIT AND HUD SECTION 8 ASSISTANCE

The credit is available to qualifying properties which also receive direct Federal assistance under HUD Section 8 programs.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that amendments to the credit should be made to bring the allocation of the credit into conformity with standard real estate practice. For example, the credit should clearly state that allocations and compliance are based on projects rather than buildings. In addition, units located on scattered sites which are commonly owned and financed should be treated as a project.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California conforms to the federal provisions prior to the 1989 OBRA changes.

REVENUE RECONCILIATION ACT OF 1989

NEW FEDERAL LAW (IRC Sec. 42(b)(1), 42(g), 42(i))

SPECIAL NEEDS HOUSING

The Act amends the definition of gross rent to exclude certain fees for supportive services which are paid to the owner of the unit by a government program or charitable organization. To qualify for the exclusion:

(1) the fees must be paid under a program which provides assistance for rent; and

(2) the amount of the assistance provided for rent is not separable from the amount of the assistance provided for supportive services.

SCATTERED SITE PROJECTS

The Act treats scattered site housing as one project if 100 percent of dwelling units are qualified low-income units and there is common plan of financing.

OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS

The Act expands eligibility for the credit to owner-occupied buildings having four or fewer units. The expansion only applies to acquisition and rehabilitation of buildings pursuant to a development plan sponsored by a State or local government or qualified nonprofit.

INTERACTION OF CREDIT AND HUD SECTION 8 ASSISTANCE

The Act denies any credit to property receiving assistance under the HUD Section 8 Moderate Rehabilitation program.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; CREDIT APPLICABLE TO TRANSITIONAL HOUSING FOR THE HOMELESS AND DENIAL OF CREDIT FOR SUBSTANDARD HOUSING

ACT SECTION: 7108(h)(1) and (i)

PRIOR FEDERAL LAW

TRANSITIONAL HOUSING

A low-income unit must not be used on a transient basis. A single room occupancy unit is not considered transient if the unit is subject to at least a six-month lease.

SUBSTANDARD HOUSING

No sanction is imposed for credit properties in violation of State or local health or building codes or regulations.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that single room occupancy units involving transient use should qualify for the credit if rent and income requirements are met.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law conforms to the federal provision prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(i))

TRANSITIONAL HOUSING

The Act expands availability of the credit to certain transitional housing for the homeless by including the portion of a building used to provide supportive services in qualified basis. In addition, the Act clarifies that month-to-month leases do not disqualify single room occupancy units for the credit.

SUBSTANDARD HOUSING

The Act provides that the credit is not available to properties in violation of State and local health or building rules or regulations. If the violation is corrected within a specified period of its report, the building is treated as having been in compliance notwithstanding the temporary violation.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; VOLUME CAP ON CREDIT ALLOCATION WHERE BUILDING IS FINANCED WITH TAX-EXEMPT BONDS

ACT SECTION: 7108(j)

PRIOR FEDERAL LAW

When 70 percent or more of the aggregate basis of a building and the land on which it is located is financed with the proceeds of tax-exempt bonds which are subject to the State's bond volume cap, the owner may claim the 30 percent present value credit for the entire eligible basis of the building without receiving an allocation under the State's annual credit cap.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

The aggregate amount of tax credits granted under the California Low-Income Housing Credit cannot exceed $35 million per year. The state does not have a provision similar to this federal provision relating to the interaction of the bond volume cap and the federal Low-Income Housing Credit cap.

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

The Act expands the present-law exception from the credit allocation requirement to properties where 50 percent or more of the aggregate basis of the building and the land on which it is located is financed by bonds subject to the State bond volume cap.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

Not applicable.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; COMMUNITY DEVELOPMENT BLOCK GRANTS AND DETERMINATION OF ELIGIBLE BASIS FOR CREDIT

ACT SECTION: 7108(k) and (l)

PRIOR FEDERAL LAW

For the new construction credit, eligible basis is determined when the property is placed-in-service.

For the acquisition and substantial rehabilitation credits, eligible basis is determined at the end of the first taxable year of the credit period. This determination is made before depreciation is taken into account.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that the definition of "placed-in-service" should be amended to ensure that all eligible costs associated with a project, including capital cost incurred by the end of the first year of the credit period, are included in basis.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law is conformed to the federal provisions prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(d), 42(e), 42(i))

The Act provides that the determination of eligible basis for all credits is made at the end of the first taxable year of the credit period.

This determination is to be made before depreciation is taken into account. Eligible basis includes proceeds of loans made through HUD Community Development Block Grants.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The Act makes the provision relating to determination of eligible basis effective as if included in the Tax Reform Act of 1986.

The treatment of HUD Community Development Block Grants is effective for housing credit dollar amounts allocated after 1989.

REVENUE RECONCILIATION ACT OF 1989

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT MAY BE ALLOCATED ON A PROJECT BASIS

ACT SECTION: 7108(m)

PRIOR FEDERAL LAW

Credits are allocated to buildings, although compliance is determined on a project basis.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that credit allocations should be made on a project basis rather than by building.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law is conformed to the federal provisions prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(h), 42(g))

The Act allows an allocation of credit on a project, rather than a building, basis. However, the conference report indicates that each building must still be assigned a separate building identification number (B.I.N.) and a separate Form 8609.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; CHANGES IN RULES FOR DEEP RENT SKEWED PROJECTS

ACT SECTION: 7108(n)

PRIOR FEDERAL LAW

To qualify under the deep rent skewing exception, at least 15 percent of the low-income units must be occupied by tenants whose incomes do not exceed 40 percent of area median income, the rents on such units must be restricted to 30 percent of the qualifying income limitation, and rents on the market rate units must be at least 300 percent of rents charged on comparable rent restricted units.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law is conformed to the federal provisions prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(g), 142(d))

The Act liberalizes the deep rent skewing rules by changing 300 percent to 200 percent.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; EXPANDS AT-RISK RULES RELATING TO FINANCING BY QUALIFIED NONPROFIT ORGANIZATIONS

ACT SECTION: 7108(o)

PRIOR FEDERAL LAW

Treats as an amount at-risk certain nonrecourse financing provided by a qualified nonprofit organization, provided that certain requirements are met, including that the financing is repaid within 90 days after the end of the 15-year compliance period.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that financing of credit projects by qualified nonprofits should be encouraged and treated in the same manner as governmental loans. Accordingly, the law should be amended to remove the 15-year repayment requirement on nonprofit debt.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law is conformed to the federal provisions prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(k))

The Act expands the present law at-risk rules for property financed by qualified nonprofit organizations by delaying the deadline for full repayment of such financing to conform to extended use period (i.e., 30 years).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; INCREASED RESPONSIBILITIES OF HOUSING CREDIT AGENCIES

ACT SECTION: 7108(o)

PRIOR FEDERAL LAW

QUALIFIED ALLOCATION PLAN

Credits are allocated by State allocating agencies. In California the Mortgage Bond and Tax Credit Allocation Committee is responsible for allocating both the federal and the California Low-Income Housing Credits.

CREDIT ALLOCATIONS TO BE LIMITED TO AMOUNT NECESSARY TO ASSURE PROJECT FEASIBILITY

For new or substantially rehabilitated property, allocating agencies may allocate up to a 70 percent present value credit. For acquisition property and federally-subsidized property, the allocating agency may allocate up to a 30 percent present value credit.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that the State allocating agency be required to devise public allocation plans and administrative guidelines governing use of the credit and establish a process for analyzing each project to establish the amount of credit it would receive.

The 1989 OBRA committee report indicates that Congress intends that allocating agencies use good faith efforts to allocate credits only to projects which can be reasonably expected to utilize such credits. It recognizes that evaluating projects for feasibility and long-term viability in awarding the credit is not an exact science but expects the credit agency to exercise sound judgement based on the information available in determining the amount of credit to be awarded. This determination is not a warranty that the project should be undertaken by the developer or involves no risk to the investor.

It also intends that if an allocating agency becomes aware that a project is not in compliance, the agency must report this noncompliance to the Internal Revenue Service.

REVENUE RECONCILIATION ACT OF 1989

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law is conformed to the federal provisions prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 42(m) new)

QUALIFIED ALLOCATION PLAN

The Act mandates the development of a plan of allocation by state allocating agencies. A qualified allocation plan is one which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions, including:

project location;
housing needs characteristics;
project characteristics;
sponsor characteristics;
participation of local tax-exempt organizations;
tenant populations with special housing needs; and
public housing waiting lists.

To be qualified, the allocation plan must also give the highest priority to those projects in which the highest percentage of the credit dollar amount is to be used for project costs and not intermediary costs (with an exception for projects in hard-to-develop areas). In addition, the allocation plan must give preference in allocating credit dollar amounts to those projects which serve the lowest income tenants and those projects obligated to serve qualified tenants for the longest periods. The plan must also provide a procedure that the agency will follow in notifying the Internal Revenue Service when the agency becomes aware of noncompliance.

CREDIT ALLOCATIONS TO BE LIMITED TO AMOUNT NECESSARY TO ASSURE PROJECT FEASIBILITY

The Act mandates that credit allocations to a building not exceed the level necessary for the financial feasibility of the project. In making the determination, the housing credit agency must consider the sources and uses of funds and the total financing planned for the project as well as any proceeds or receipts expected to be generated by reason of tax benefits.

This determination is required as of the following three dates:

1. When the application for the housing credit dollar amount is made;

2. When the allocation of the housing credit dollar amount is made; and

3. The date the building is placed in service.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING; TIME FOR CERTIFICATION

ACT SECTION: 7108(p)

PRIOR FEDERAL LAW

Required that credit forms be filed within 90 days after the end of each taxable year in the credit period.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

California law is conformed to the federal provisions prior to the 1989 OBRA changes except that the reports are sent to the Mortgage Bond and Tax Credit Allocation Committee.

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

The Act allows the taxpayer to file credit forms on the same day as required for filing tax returns.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

No revenue impact.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT: EXTENDS LOW-INCOME USE PERIOD

ACT SECTION: 7108(c) and (q)

PRIOR FEDERAL LAW

A building for which the owner receives a credit allocation is subject to a 15-year compliance period during which that part of the building for which the credits are claimed must be rented to low-income tenants at restricted rents.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that the credit should be amended to encourage extended low-income use beyond the initial 15-year compliance period.

CURRENT CALIFORNIA LAW (Sec. 17058, 23610.5)

Since its inception, the California Low-Income Housing Tax Credit has required an initial 30 year compliance period versus the 15-year federal compliance period.

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

The Act requires a 30-year extended low-income use agreement for credit eligibility.

If the taxpayer is unable to transfer property at the end of the initial (15 year) compliance period for continued low-income use, the allocating agency, upon being given written notice of the taxpayer's intent to dispose of the property, is allowed one year to find an eligible buyer at a specified price based on outstanding indebtedness and investor equity contributions. The taxpayer may trigger this one-year period anytime after the 14th year of the compliance period. If no such buyer is located, the property may be converted to market rate use with the qualification that existing low-income tenants may not be evicted within three years after the end of the compliance period.

The Act also provides that the allowance by the owner of certain rights of first refusal to low-income tenants will not affect tax benefits associated with the credit.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for determinations made under Section 42 of the IRC with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989. For projects not subject to the credit allocation limits, the provision generally applies to buildings placed in service after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

Not applicable. California currently requires a 30-year compliance period.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSIONS OF CERTAIN EXPIRING TAX PROVISIONS

ACTION: LOW-INCOME HOUSING CREDIT; EXEMPT THE CREDIT FROM PASSIVE LOSS PHASE-OUT RULES

ACT SECTION: 7109

PRIOR FEDERAL LAW (IRC Sec. 469)

Credits from passive activities generally are limited to the tax attributable to the passive activities. A special $25,000 allowance is provided in the case of passive activity losses and the deduction equivalent amount of credits attributable to rental real estate activities. In the case of low-income housing and rehabilitation tax credits, the $25,000 (deduction equivalent) amount is allowed regardless of whether the taxpayer actively participates in the activity, and is phased out ratably as the taxpayer's adjusted gross income, with certain modifications, increases from $200,000 to $250,000.

REASON FOR CHANGE

The Mitchell-Danforth Task Force on the Low-Income Housing Tax Credit recommended that the pool of potential investors be expanded by amending the treatment of passive losses associated with the investment in low-income housing. It stated that improvements to the program which it was recommending would have the effect of expanding the pool of potential investors without violating the goal of tax reform to limit tax shelters to any individual investor.

CURRENT CALIFORNIA LAW (Sec. 17561, 24692)

California law is conformed to the federal provisions prior to the 1989 OBRA changes except that the deduction equivalent for state purposes is $75,000 versus the federal $25,000 amount.

NEW FEDERAL LAW (IRC Sec. 469(i)(3)(B), (C), (D) new)

The $25,000 deduction equivalent allowance is modified by removing the $200,000 to $250,000 adjusted gross income phaseout, in the case of low-income housing tax credits.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision relating to the $25,000 allowance under the passive loss rules is effective for property placed in service after December 31, 1989. If the property is held through a partnership or other pass-thru entity, the taxpayer's interest in the partnership or other pass-thru entity must have been acquired after December 31, 1989.

REVENUE RECONCILIATION ACT OF 1989

IMPACT ON CALIFORNIA REVENUE

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.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIA: EXTENSION OF EXPIRING TAX PROVISIONS

ACTION: EXTENSION AND MODIFICATION OF THE RESEARCH AND EXPERIMENTATION TAX CREDIT

ACT SECTION: 7110

BACKGROUND

In 1981, a research and experimentation (R&E) tax credit was enacted to provide an incentive for American businesses to invest in research. The credit was extended by the 1986 Tax Reform Act and the 1988 Technical and Miscellaneous Revenue Act.

PRIOR FEDERAL LAW (IRC Sec. 28, 41, 174, 196, 280C(c))

Incremental Credit:

The incremental credit allows taxpayers to reduce their tax liability by 20 percent of qualified expenditures that exceed a base amount. The base amount is equal to the previous 3-year average of qualified expenditures, or 50 percent of the taxpayer's current year expenditures, which ever is greater.

Research expenditures eligible for the 20 percent incremental credit consist of (1) "in-house" expenditures by the taxpayer for research wages and supplies used in research; (2) certain time-sharing costs for computer use in research; and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf. Expenditures attributable to research which is conducted outside the United States do not qualify. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research funded by any grant, contract, or otherwise by another person (or governmental entity).

University Basic Research Credit:

In addition to the 20 percent incremental credit, there is a 20 percent tax credit for certain corporate expenditures for university basic research. This credit applies to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for university basic research over (2) the fixed-base percentage for the proceeding two years, as computed to the base period, plus any decrease for nonresearch corporate contributions, adjusted for inflation.

REVENUE RECONCILIATION ACT OF 1989

Relation of Credit to Section 174 Deduction:

Beginning after 1988, the amount of any deduction allowable to a taxpayer under IRC Section 174 or any other provision for qualified research expenditures is reduced by an amount equal to 50 percent of the taxpayer's research credit determined for that year.

Expiration of Tax Credit

This credit expired December 31, 1989.

CURRENT CALIFORNIA LAW (Sec. 17052.12, 23609)

California law is conformed to federal law by reference, with the following exceptions:

(1) The R&E tax credit is set to expire on December 31, 1992.

(2) The California credit is 8% for qualified research expenses which exceed average base period expenses. In the case of payments by a corporation for basic research conducted by a university or research institution, the credit is 12%.

(3) The tax credit is limited to research conducted in California and is allowed to reduce the regular tax below the tentative minimum tax.

(4) Current state law allows for the R&E expense to be a deduction allowed under IRC Section 174 as ordinary cost of business, reduced by 50% of the credit.

REASON FOR CHANGE

Businesses often determine their research budgets as a fixed percentage of gross receipts, by allowing indexing of the base amounts to the average growth of gross receipts, the credit will achieve its intended purpose of rewarding taxpayers for research in excess of amounts which would have been expended regardless of a credit incentive. Using gross receipts as an index, firms in fast growing sectors will not be unjustly rewarded of their research intensity. Likewise, firms in a slow growth sector will be able to earn credits as long as they maintain research expenditures in relation with their own sale growth.

It is recognized that the research credit is equivalent of a federal payment to the taxpayer (the taxpayer does not pay for research to the extent of the credit), therefore the deduction allowed under IRC Section 174 for research expenses should be reduced by the full amount of the research credit.

REVENUE RECONCILIATION ACT OF 1989

NEW FEDERAL LAW (IRC Sec. 28, 41, 174, 196, 280C(c))

The 20 percent R&E credit is allowed to the extent that a taxpayer's qualified research expenditures for the current year exceeds its base amount for that year.

Base Amount Computation:

The base amount for the current year is computed by multiplying the taxpayer's fixed-base percentage by the average amount of the taxpayer's gross receipts for the four preceding years. In no event can the fixed-base percentage exceed .16.

Start-Up Companies:

Start-up companies not having incurred qualified research expenses and gross receipts for at least three years in the five year period 1984-1988, are assigned a fixed-base percentage of .03. Start-up firms with an infancy fixed-base percentage of .03 are subject to a base limitation of 65 percent for taxable years beginning in 1990 through 1993, 70 percent for taxable years beginning in 1994, and 75 percent for taxable years beginning in 1995.

Existing Firms:

If a taxpayer incurred both qualified research expense and had gross receipts during each of at least three years from 1983 to 1988, then its fixed-base percentage is the ratio of its total qualified research expenses for any five years selected by the taxpayer during the 1983-1988 period, subject to the maximum ratio limitation of 20 percent.

Base Limitations:

As under current, law a taxpayer's base may not be less than a certain percentage of current-year qualified research expenditures. The base limitation percentage is 50 percent for taxable years beginning in 1990, 55 percent for taxable years beginning in 1991; 60 percent for taxable years beginning in 1992; 65 percent for taxable years beginning in 1993; 70 percent for taxable years beginning in 1994; 75 percent for taxable years beginning in 1995 or later.

Eligible Expenditures:

The expenditures eligible for the credit are the same as under present law. The rules relating to aggregation of related persons and changes in business ownership are the same as under present law, with the modification that when a business changes hands, qualified research expenses and gross receipts for periods prior to the change of ownership are treated as transferred with the trade or business which gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage. In addition, the new federal law provides that a foreign affiliate's gross receipts which are not effectively connected with the conduct of a trade or business in the United States do not enter into the computation of the credit.

Relationship of Credit to IRC Section 174 Deductions:

The amount of any deduction allowable to a taxpayer under Section 174 or any other provision for qualified research expenditures is reduced by an amount equal to 100 percent of the taxpayer's research credit determined for that year.

Election to Avoid IRC Section 41 Reduction:

A taxpayer is permitted to avoid the reduction of R&E expenses as allowed by IRC Section 174, by electing not to utilize the research credit provided by IRC Section 41. Once made, the election to forgo the research credit is irrevocable.

The Treasury Department is authorized to prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts due to a change in accounting methods used by the taxpayer between the current year and a year taken into account in computing the taxpayer's fixed base percentage. In addition the Treasury Department is authorized to provide regulation on the minimum amount of qualified research expense and gross receipts that may be disregarded.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions are effective for taxable years beginning after December 31, 1989. The incremental credit expires on September 30, 1990, and the university credit expires December 31, 1990.

IMPACT ON CALIFORNIA REVENUE

The provision requiring the deduction to be reduced by 100% of the credit would reduce state revenue losses from its credit by perhaps $1-2 million for 1990 and decreasing thereafter.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: DIVIDES THE YIELD ON CERTAIN HIGH YIELD OID OBLIGATIONS INTO INTEREST AND DIVIDENDS

ACT SECTIONS: 7202(a) and (b)

PRIOR FEDERAL LAW (IRC Sec. 163)

Original issue discount (OID) is the excess of the stated redemption price at maturity over the issue price of a debt instrument. The issuer of a debt instrument with OID generally accrues and deducts the discount, as interest, over the life of the obligation even though the amount of such interest is not paid until the debt matures. The holder of such a debt instrument also generally includes the OID in income, as interest, as it accrues.

A corporation generally cannot deduct distributions made with respect to its stock. In certain circumstances, a corporation is entitled to a deduction equal to a percentage of dividends received from a corporation (IRC Sec. 243, 245, 246 and 246A) (the "dividends received deduction").

CURRENT CALIFORNIA LAW (Sec. 17224, 24344.5)

California law is conformed to prior federal law in taxable/income years beginning after December 31, 1986. A special rule applies to obligations issued after June 9, 1984, and before January 1, 1987, to require an adjustment in the year of disposition to take into account the difference between federal and California income and deductions before 1987.

With respect to the dividends received deduction, California is not conformed to the federal provision which allows a corporation to deduct 70 percent (80% for dividends from a 20% owned corporation) of the amount of dividends received from another domestic corporation and 100 percent of qualifying dividends received from an affiliated corporation.

California law, instead, excludes from a corporation's taxable income dividends which are paid out of income which has been subject to either the state franchise tax or the state corporation income tax in the the hands of the paying corporation. The intent of this provision is to avoid double taxation of corporation income at the state level. In order for the recipient corporation to claim such a deduction, the paying corporation must have had income from sources in California which required the filing of a California franchise or income tax return. The Franchise Tax Board makes a computation each year after the returns are filed, to determine the percentage of dividends paid which is deductible by the recipient corporations.

REVENUE RECONCILATION ACT OF 1989

NEW FEDERAL LAW (IRC Sec. 163(e)(5), 163(i))

According to the conference committee report, Congress believes that a portion of the return on certain high yield OID obligations is more like a return on equity (i.e. a dividend) rather than interest. Thus, new federal law splits the OID into two pieces:

(1) an interest element that is deductible only when paid but is currently includible in income of the recipient on an accrual basis; and

(2) a dividend element (called the "disqualified portion") which is not deductible by the paying corporation but is includible in the recipient's income as a dividend and subject to the dividend received deduction calculation.

The "disqualified portion" of the OID is defined as the lesser of (1) the amount of the OID or (2) the portion of the total return on the obligation that bears the same ratio to the total return as the "disqualified yield" on the obligation bears to the yield to maturity on the obligation. The term "disqualified yield" means that portion of the yield that exceeds the applicable federal rate for the month in which the obligation is issued plus six percentage points.

The above rules do not apply to any obligation issued by any corporation for any period that the corporation was an S corporation.

Act Section 7202(b) provides that these rules apply to any debt instrument if (1) its maturity date is more that five years from the date of issue, (2) its yield to maturity is at least equal to the sum of the applicable federal rate for the calendar month in which it was issued, plus six percentage points, and (3) it has significant original issue discount.

The following example illustrates the application of the rules that pertain to high yield OID obligations:

> A corporation issues an applicable instrument at the beginning of the year. The instrument has an issue price of $100 and a yield to maturity of 20%. In the month of issue, the applicable federal rate (AFR) is 9%. The AFR plus 6 percentage points is 15%. The return on the instrument in the first year is $20 ($100 issue price x 20% yield to maturity) and the adjusted issue price is $120 at the end of the year. The return on the instrument in the second year is $24 ($120 adjusted issue price x 20% yield to maturity). The ratio of the disallowed portion of the yield to the total yield is 25% (20% yield to maturity (less 15%) divided by 20% yield to maturity). The amount of the disqualified portion (i.e., the dividend) in the first year is $5 ($20

return for the first year x 25%). Thus, the disallowed portion (i.e., the dividend) in the second year is $6 ($24 return for the year x 25%).

If the issuer distributes $12 in cash with respect to the instrument at the end of the second year, $3 ($12 x 25%) will be considered to be a payment of the accrued but unpaid disqualified portion (i.e., the dividend), and the issuer will be allowed an interest deduction of $9 ($12 minus $3).

The purchaser of the obligation, however, reports interest income of $15 and dividend income of $5 (subject to the dividends received deduction) in the first year and interest income in the second year of $18 and dividend income of $6 (subject to the dividends received deduction).

EFFECTIVE DATE OF FEDERAL PROVISIONS

Generally, the provisions that pertain to high yield OID obligations apply to instruments issued after July 10, 1989. Exceptions to the general effective date are provided for in the case of (1) instruments issued in connection with certain acquisitions, (2) certain refinancing instruments, and (3) instruments issued in certain bankruptcy proceedings.

IMPACT ON CALIFORNIA REVENUE

Based on rather modest revenue gains projected for the nation, comparable state revenues gains would range from $2 to $6 million over the initial four year period beginning with 1990-91.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: TAXES DEBT OBLIGATIONS RECEIVED IN AN OTHERWISE TAX FREE TRANSACTION

ACT SECTION: 7203

PRIOR FEDERAL LAW (IRC Sec. 351)

No gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately thereafter such person or persons are in control of the corporation (IRC Section 351). Accordingly, a transferor may transfer appreciated property to a corporation in exchange for stock and a debt obligation of the corporation that is a security, without recognition of gain.

Debt obligations that are not considered to be securities under IRC Section 351 are treated as "boot". A transferor who receives boot is taxed on the lesser of the amount of the boot or the gain realized on the exchange.

Under the corporate reorganization provisions, if a taxpayer transfers property in a reorganization and receives securities with a principal amount in excess of any securities surrendered, such excess is treated as boot. Such a taxpayer must recognize gain, if any, to the extent of the boot received in the exchange.

The receipt of any debt obligation constituting boot generally qualifies for installment sale treatment.

CURRENT CALIFORNIA LAW (Sec. 17321, 24521)

California law is conformed to prior federal law but the provision relating to the transfer of property to an investment company contained in federal law does not apply to the state.

REASON FOR CHANGE

The Senate Finance Committee's report explained that, since the committee believed that a transferor who receives debt obligation in an IRC Section 351 transaction does not continue an investment in the transferred assets to the extent of the debt obligation received, it is more appropriate to characterize the transaction as a taxable sale (to the extent of the debt obligation received) than as a tax-free exchange.

REVENUE RECONCILATION ACT OF 1989

NEW FEDERAL LAW (IRC Sec. 351)

The Act provides that a transferor that transfers appreciated property to a corporation in exchange for stock and a debt obligation of the corporation that is a security generally must recognize gain. Previously, a transferor could complete such a transaction without recognition of gain because only debt obligations that were not considered to be securities under IRC Section 351 were treated as boot.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision generally applies to transfers made after October 2, 1989, in tax years ending after that date (with exceptions for binding contracts). This provision also applies to property transfers (either directly or indirectly through a partnership or otherwise) by a C corporation after July 11, 1989, and before October 3, 1989 (with exceptions for binding contracts).

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $18 million range for 1990-91, $12 million range for 1991-92, 1992-93 and $14 million range for 1993-94.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: EXCLUDES CERTAIN MUTUAL FUND LOAD CHARGES FROM BASIS

ACT SECTION: 7204(b)

PRIOR FEDERAL LAW (IRC Sec. 852)

A shareholder's basis in shares purchased in a regulated investment company (mutual fund) includes an advance charge for sales fees (load charge) upon purchase of the shares.

A load charge is any sales or similar charge incurred in acquiring stock of a regulated investment company. The term does not include a charge incurred by reason of the reinvestment of a dividend.

CURRENT CALIFORNIA LAW (Sec. 17088, 24412)

California conforms to federal provisions dealing with regulated investment companies (RICs) with the exception that California allows RICs to deduct exempt interest dividends distributed to shareholders to the extent that the interest was included in gross income. California taxes a RIC only on its undistributed income, but the RIC is liable for the minimum franchise tax.

NEW FEDERAL LAW (IRC Sec. 852(f))

The Act provides that a load charge would not be taken into account in determining a shareholder's basis in mutual fund shares that are sold or exchanged within ninety days if the shareholder subsequently acquires mutual fund shares pursuant to a reinvestment right. A reinvestment right includes the right to reinvest the proceeds from the sale or exchange of the shares in the original mutual fund at a reduced charge in one or more mutual funds.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for load charges incurred after October 3, 1989, in taxable years ending after that date.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, state revenue gains would be rather minor, in the $1.5 million range for the first year and decreasing thereafter.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: REQUIRES MUTUAL FUNDS TO INCLUDE DIVIDEND INCOME ON EX-DIVIDEND DATE

ACT SECTION: 7204(c)

PRIOR FEDERAL LAW (IRC Sec. 852(b))

Dividends from stock owned by a regulated investment company (RIC), commonly called a "mutual fund", are includible in the company's income when received.

CURRENT CALIFORNIA LAW (Sec. 17088, 24412)

California conforms to federal provisions dealing with regulated investment companies (RICs) with the exception that California allows RICs to deduct exempt interest dividends distributed to shareholders to the extent that the interest was included in gross income.

California taxes a RIC only on its undistributed income, but the RIC is liable for the minimum franchise tax.

NEW FEDERAL LAW (IRC Sec. 852(b)(9))

The Act provides that dividends on stock owned by a RIC must be included in the company's income no later than the date on which the dividend was declared by the issuing corporation or the date on which the RIC acquired the share. Previously, a RIC could wait until it had received the dividend before including it in its income. The RIC would be entitled to a loss when it is established that the dividend will not be received.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This rule applies to dividends where the ex-dividend date occurs after the enactment date of the Act.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, comparable accelerations in tax revenues at the state level would be in the $5 million range for 1990-91, dropping to the $1 million range thereafter.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: REDUCES THE THRESHOLD TO FURTHER RESTRICT THE USE OF BUILT-IN GAINS AND LOSSES WHEN THERE ARE CERTAIN CHANGES IN THE CONTROL OF A CORPORATION

ACT SECTION: 7205

PRIOR FEDERAL LAW (IRC Sec. 56, 382)

Prior law restricted the use of built-in losses and built-in gains of a corporation when there were certain changes in the control of a corporation. These limitations were triggered only if the new unrealized built-in gain or loss exceeds 25 percent of the fair market value of its assets. Under the alternative minimum tax adjusted current earnings rules, built-in losses were limited, without a threshold, if there were certain changes in control of a corporation.

CURRENT CALIFORNIA LAW (Sec. 24356, 24592, 24594)

California conforms generally to prior federal law.

NEW FEDERAL LAW (IRC Sec. 56(g)(4)(H), 382(h)(3))

The Act changed the threshold on the use of built-in gains and built-in losses of a corporation so that the restrictions will apply if the built-in loss or built-in gain exceeds the lesser of (1) 15 percent of the fair market value of the assets of the corporation or (2) $10 million. A corresponding threshold is provided for built-in losses under the alternative minimum tax adjusted current earnings rules.

This change also has an impact on the limitation set by IRC Section 384. Under that section, when a corporation joins an affiliated group, there is a five-year moratorium on the mixing of preaffiliation losses with postaffiliation recognized built-in gains between the new corporation and the members of the group. The new law allows recognized built-in gains to be offset by losses as long as the net unrealized built-in gains of a corporation do not exceed the new 15 percent/$10 million limitation.

EFFECTIVE DATE OF FEDERAL PROVISIONS

These provisions generally are effective for ownership changes and acquisitions that take place after October 2, 1989, in tax years ending after that date. Exceptions are provided for: (1) ownership changes or acquisitions made pursuant to a binding written contract in effect on October 2, 1989, and continuously thereafter before such change or acquisition; (2) certain bankruptcy proceedings where a petition is filed before October 3, 1989; and (3) built-in losses of subsidiaries of bankrupt parents.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $10 million range for fiscal years 1990-91 and 1991-92, increasing to $11 and $12 million range for 1992-93 and 1993-94 respectively.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: REQUIRES BASIS REDUCTION FOR CERTAIN PREFERRED STOCK EXTRAORDINARY DIVIDENDS

ACT SECTION: 7206

PRIOR FEDERAL LAW (IRC Sec. 1059)

In general, corporations are entitled to a deduction equal to 70 percent (80 percent and 100 percent in certain cases) of the dividends received from a domestic corporation. A corporate shareholder's basis in stock is reduced by the portion of a dividend eligible for the dividends received deduction if the dividend is "extraordinary".

A dividend is "extraordinary" if the shareholder has held the stock for at least two years and the amount of the dividend is 10 percent (5 percent for preferred stock) or more of the shareholder's basis of the stock.

CURRENT CALIFORNIA LAW (Sec. 18031, 24966)

California law generally is the same as federal law requiring the basis of stock to be reduced by the nontaxed portion of any extraordinary dividend received. The primary difference from federal law is the substitution of the dividends received deduction provided under Section 24402 for that provided under IRC Section 243, 244 or 245.

NEW FEDERAL LAW (IRC Sec. 1059)

Act Section 7206 amends IRC Section 1059 providing that dividends with respect to certain preferred stock are treated as extraordinary dividends (without regard to the period the taxpayer held the stock), thus requiring a reduction in stock basis. This provision applies to dividends with respect to preferred stock if: (1) at the time the preferred stock is issued, such stock has a dividend rate that declines, or can reasonably be expected to decline, in the future; (2) the issue price of such stock exceeds its liquidation rights or its stated redemption price; or (3) such stock is otherwise structured to enable corporate shareholders to reduce tax through a combination of dividend received deductions and loss on the disposition of the stock.

Stock and dividends subject to this provision include instruments that are treated as stock under IRC Section 386 or any other provision of law. Further, dividends subject to the provision include dividends deemed received under IRC Section 305 or any other provision.

The effect of IRC Section 305, and other provisions of law on the timing and amount of the dividend, must be taken into account in making a determination as to whether a dividend rate declines or whether the stock would otherwise be subject to this provision. For example, if the dividend rate on preferred stock does not decline by its terms, but other provisions of law, such as IRC Section 305, have the effect of causing the stock to have a declining dividend rate, this provision will apply. However this provision is not intended to apply to dividends on preferred stock whose dividend rate declines due to an unforeseen economic downturn in the issuer's business.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision generally applies to stock issued after July 10, 1989, in tax years ending after that date. It does not apply, however, to any stock issued pursuant to a written binding contract that is in effect on July 10, 1989, and at all times thereafter before the stock is issued.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation which indicate negligible revenue gains, comparable state revenue gains would be minor, in the $500,000 range annually.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: CLARIFIES TREASURY DEPARTMENT AUTHORITY TO CHARACTERIZE AN INSTRUMENT AS PART DEBT AND PART EQUITY

ACT SECTION: 7208(a)

BACKGROUND

The characterization of an investment in a corporation as debt or equity for Federal income tax purposes generally is determined by reference to numerous factors that are deemed to reflect aspects of the economic substance of the investor's interest in the corporation. Generally, there has been a tendency by the courts to characterize an instrument entirely as debt or entirely as equity.

PRIOR FEDERAL LAW (IRC Sec. 385(a))

The Secretary of the Treasury is authorized to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated as stock or indebtedness.

CURRENT CALIFORNIA LAW (Sec. 17321, 24580)

California law conforms to IRC Section 385, relating to the authority to prescribe regulations pertaining to the treatment of interests in corporations as stock or indebtedness.

NEW FEDERAL LAW (IRC Sec. 385(a))

Act Section 7208(a) amends IRC Section 385(a) to give the Treasury authority to characterize a corporate instrument that has significant debt and equity characteristics as part debt and part equity. Any regulations issued pursuant to this authority will only apply to instruments issued after the date on which public guidance, in the form of regulations, rulings, or otherwise, is given on such instruments.

EFFECTIVE DATE OF FEDERAL PROVISIONS

December 19, 1989.

IMPACT ON CALIFORNIA REVENUE

The Joint Committee on Taxation has projected that Treasury regulatory activity in this area over the near term will not result in meaningful revenue gains. Comparable state revenue gains would be negligible.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: REQUIRES THE REPORTING TO THE IRS OF CERTAIN ACQUISITIONS AND RECAPITALIZATION TRANSACTIONS

ACT SECTION: 7208(b)

BACKGROUND

There is no requirement under present law that the parties to an acquisition or recapitalization transaction report information to the Treasury Department or the Internal Revenue Service with respect to such transaction, except as incident to the filing of Federal income tax returns.

PRIOR FEDERAL LAW (IRC Sec. 6043, 6652)

IRC Section 6043 requires corporations to file information returns with the IRS regarding liquidation, dissolution, termination, or contraction.

CURRENT CALIFORNIA LAW (Sec. 18683, 25933)

California has no provision comparable to IRC Section 6043, relating to the filing of information returns regarding liquidation, dissolution, termination, or contraction. However, Sections 18683 and 25933 provide for the imposition of a penalty for failure to furnish information upon request.

NEW FEDERAL LAW (IRC Sec. 6043(c), 6043(d), 6652(l))

The Act imposes new reporting requirements upon parties involved in acquisitions, recapitalizations and capital restructuring of corporations. When required, affected corporations must file an information return reporting: (1) the identities of parties to the transaction; (2) the fees involved; (3) any changes to the capital structure of the corporation; and (4) any other information that the Treasury Department may require to be reported with respect to the transaction. The Treasury Department is directed to exempt small transactions from these reporting requirements.

The Act also provides a penalty for failure to file that information return in the amount of $500 for each day that the return is outstanding, up to a maximum penalty of $100,000. In addition the criminal penalty provisions of IRC Sections 7203, 7206 and 7207 apply.

REVENUE RECONCILATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision is effective for transactions occurring after March 31, 1990.

IMPACT ON CALIFORNIA REVENUE

California has not conformed previously in this area of information reporting. Any revenue potential that may result from such reporting at the state level is conjectural. The Joint Committee on Taxation has estimated negligible revenue gains for the nation from this reporting change.

REVENUE RECONCILATION ACT OF 1989

TITLE VIIB: CORPORATE PROVISIONS

ACTION: LIMITS DEDUCTION FOR INTEREST PAID TO RELATED TAX-EXEMPT PERSONS

ACT SECTION: 7210

PRIOR FEDERAL LAW (IRC Sec. 163)

Interest expenses of a U.S. corporate taxpayer are generally deductible, whether or not the interest is paid to a related party and whether or not the interest income is subject to U.S. taxation as received by the recipient.

CURRENT CALIFORNIA LAW (Sec. 17201, 24344)

California incorporates by reference the federal rules generally providing a deduction of all interest paid or accrued on business debts. California does not have a provision similar to new federal law which disallows interest deductions for payments to tax-exempt related party corporations which are made by a thinly capitalized corporation. California does however restrict interest expense deductions of multistate and multinational corporations subject to allocation and apportionment, when their total interest expenses, less expenses deducted in arriving at net nonbusiness income, exceed business (apportionable) interest income. Deductible expenses attributable to nonbusiness income include those incurred for foreign investment, which may be offset against dividends deductible under Section 24411.

The exclusion of dividends deductible under Section 24402 applies to foreign domiciliary corporations as well as to California corporations.

NEW FEDERAL LAW (IRC Sec. 163(j))

The Act provides that certain interest paid or accrued by a corporation to related tax-exempt persons is not deductible. Such interest is termed "disqualified interest." However, the interest deduction may not be denied unless the corporation has "excess interest expense" for the tax year and the "ratio of debt to equity" of the corporation at the close of the taxable year exceeds 1.5 to 1. Special rules are provided for partnerships.

The "ratio of debt to equity" is the ratio of the total indebtedness of the corporation to the sum, of its money and all other assets, less such total indebtedness. The amount taken into account with respect to any asset is that asset's adjusted basis for determining gain.

REVENUE RECONCILATION ACT OF 1989

The term "excess interest expense" means the excess of the corporation's net interest expense over the sum of 50 percent of its adjusted taxable income, plus any excess limitation carryforward. "Adjusted taxable income" is defined as the corporation's taxable income, computed without regard to (a) deductions for the net interest expense, (b) net operating loss deductions and (c) deductions allowable for depreciation, amortization, or depletion.

If a corporation is not subject to interest disallowance it has an "excess limitation" for that tax year. The amount of the "excess limitation" is the difference between 50 percent of its adjusted taxable income for the year and its net interest expenses. That amount becomes an "excess limitation carryforward" to the first succeeding tax year. To the extent it is not taken into account for that first tax year, it is carried forward to the second succeeding tax year, and, to the extent it is not taken into account for the second year, it is carried forward to the third succeeding tax year. However, the amount of carryforwards taken into account for a succeeding tax year may not exceed the excess interest expense for that year, as determined without regard to carryforwards from tax years that had excess limitations.

The following example illustrates the operation of this provision:

Assume that for 1990 a corporation has $150 of adjusted taxable income and $60 of net interest expense. The corporation is not subject to disallowance of interest deductions because it does not have excess interest expense. In addition, it has an excess limitation for 1990 of $15.

The corporation, in 1991, has $100 of adjusted taxable income and $60 of net interest expense. For 1991, the sum of 50% of adjusted taxable income ($50) and the excess limitation carryforward from 1990 that may be taken into account for 1991 equals $60 ($50 + $10). Under these assumptions, the corporation is not subject to disallowance of interest deductions for 1991.

The corporation, in 1992, has $100 of adjusted taxable income and $60 of net interest expense. For 1992, the sum of 50% of adjusted taxable income and the excess limitation carryfoward from 1990 that may be taken into account for 1992 equals $55 ($50 + $5). Therefore, the corporation may now be subject to the disallowance of up to $5 of interest deductions if it paid disqualified interest for 1992 and if its debt equity ratio for that year exceeds 1.5 to 1.

For purposes of the new rules regarding interest paid to tax-exempt related persons, all members of the same affiliated group of corporations are treated as one taxpayer.

REVENUE RECONCILATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

Generally, the rules concerning the deductibility of interest paid to tax-exempt related persons only apply to interest paid or accrued in tax years beginning after July 10, 1989. However, in the case of any demand loan, or other loan without a fixed term that was outstanding on July 10, 1989, interest on the loan to the extent attributable to periods before September 1, 1989, will not be treated as disqualified interest.

IMPACT ON CALIFORNIA REVENUE

Revenue gains estimated by the Joint Committee on Taxation for the nation are rather insignificant and largely reflect "excess" interest payments to foreign parent corporations and foreign subsidiaries which are not subject to U.S. taxation.

Adoption of a similar limitation at the state level would most likely result in minor revenue gains. Gains would be minimized due to excess interest expense, related person, and debt/equity definitions that apply. However, the issue of interest expense payments to foreign (non-U.S.) entities under the water's-edge reporting would have to be addressed.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIC: EMPLOYEE BENEFIT PROVISIONS

ACTION: EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs); LIMIT PARTIAL INTEREST EXCLUSION FOR ESOP LOANS

ACT SECTION: 7301

PRIOR FEDERAL LAW (IRC Sec. 133)

Banks and certain other financial institutions may exclude from gross income 50 percent of the interest received with respect to a securities acquisition loan. In 1989, the IRS ruled that a lender may qualify for the partial interest exclusion regardless of whether the original lender was qualified lender or whether each prior lender was a qualified lender (Rev. Rul. 89-76).

REASON FOR CHANGE

According to reports of committee hearings on the subject of "leveraged buy outs" (LBOs), the participation of ESOPs in this process was of concern to Congress and certain ESOP rule changes were made in the 1989 OBRA.

CURRENT CALIFORNIA LAW (Sec. 17131, 24306)

Starting January 1, 1990, California conforms to the federal law prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 133(b)(6))

Under the Act, partial interest exclusion is not available unless the ESOP owns more than 50 percent of (1) each class of outstanding stock of the corporation issuing the employer securities, or (2) the total value of all outstanding stock of the corporation. Options held by the ESOP are not counted toward the 50 percent requirement. In accordance with Revenue Ruling 89-76, the more than 50 percent requirement may be satisfied by counting all stock in any ESOP maintained by the employer (or other member of the employer's controlled group). However, the partial interest exclusion does not apply to interest allocable to any period during which the ESOP does not meet the more than 50 percent requirement.

The participants in an ESOP are entitled to direct how the employer securities acquired with the loan (or transferred to the ESOP) and allocated to their account are to be voted.

The Act also provides that there is a 15-year limitation on the term of securities acquisition loans and imposes a 10 percent excise tax if certain events happen within 3 years after the securities are acquired by the ESOP or transferred to the ESOP.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is generally effective for loans made after July 10, 1989. Numerous transitional rules are provided.

IMPACT ON CALIFORNIA REVENUE

If this measure is adopted in 1990 for state tax purposes, the revenue loss for the 50% interest exclusion under AB 3799 (Stats. 1988, Ch. 1504) would be largely eliminated. That state impact was originally estimated at $6 million for 1990 but now appears should be much higher (perhaps $24 million) based on Joint Committee on Taxation's latest estimates of the level of ESOP debts.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIC: EMPLOYEE BENEFIT PROVISIONS

ACTION: EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs); LIMITATION ON DIVIDENDS PAID DEDUCTION

ACT SECTION: 7302

PRIOR FEDERAL LAW (IRC Sec. 404(k)

In certain circumstances an employer is allowed to deduct dividends paid on securities held by an ESOP to the extent the dividends are (1) paid out currently to plan participants or (2) used to repay a loan used to acquire employer securities.

CURRENT CALIFORNIA LAW (Sec. 17501, 24603)

Starting on January 1, 1990, the California law conforms to the federal law prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 404(k))

Dividends may be used to repay an acquisition loan only if those dividends are paid with respect to employer securities acquired with that loan.

As under present law, a loan does not have to qualify as a securities acquisition loan under Section 133 in order for the dividend deduction to apply to dividends used to repay the loan.

No inference is intended as to the scope of the dividend deduction prior to the effective date of the provision. In addition, no inference is intended with respect to the permissible sources of payments on exempt loans under Title I of the Employee Retirement Income Security Act of 1974.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for securities acquired by the ESOP after August 4, 1989, other than securities acquired with the proceeds of a loan made pursuant to a written binding commitment in effect on August 4, 1989, to the extent the proceeds of such loan are used to acquire employer securities pursuant to a written binding contract (or tender offer) in effect on August 4, 1989. Employer securities are not considered to have been acquired by an ESOP on or before August 4, 1989, for example, if the securities were acquired by a qualified plan on or before August 4, 1989, but the plan was not an ESOP until after August 4, 1989.

REVENUE RECONCILIATION ACT OF 1989

IMPACT ON CALIFORNIA REVENUE

By adopting this federal change, state revenue losses beginning in 1990 would be reduced by $4 to $5 million annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIC: EMPLOYEE BENEFIT PROVISIONS

ACTION: EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs); LIMIT DEFERRAL OF GAIN ON SALE OF STOCK TO AN ESOP

ACT SECTION: 7303

PRIOR FEDERAL LAW (IRC Sec. 1042)

If certain requirements are satisfied, a taxpayer is permitted to elect to defer recognition of gain on the sale of qualified securities to an ESOP to the extent that the taxpayer reinvests the proceeds in qualified replacement property within a replacement period (Sec. 1042).

CURRENT CALIFORNIA LAW (Sec. 18042, 24954)

Starting January 1, 1990, California conforms to the federal law prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 1042(b)(4))

The deferral of recognition of gain on the sale of qualified securities to an ESOP is available only if, in addition to all the other requirements, the taxpayer holds the securities for at least 3 years before the sale of stock to an ESOP.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for sales to an ESOP after July 10, 1989.

IMPACT ON CALIFORNIA REVENUE

By adopting this federal requirement, state revenue losses beginning in 1990 would be reduced by perhaps $200,000 annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIC: EMPLOYEE BENEFIT PROVISIONS

ACTION: EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs); LIMIT ON CONTRIBUTIONS AND BENEFITS UNDER AN ESOP

ACT SECTION: 7304(c)

PRIOR FEDERAL LAW (IRC Sec. 415)

In general, the maximum annual additions that can be made to the account of plan participants under a defined contribution plan is the lesser of (1) 25 percent of the participant's compensation, or (2) $30,000. If no more than 1/3 of the employer contributions to an ESOP for a year are allocated to highly compensated employees, then the dollar limit on annual additions to the ESOP is equal to the sum of (1) the regularly applicable dollar limit, and (2) the lesser of such dollar limit or the amount of employer securities contributed, or purchased with cash contributed to, the ESOP (Sec. 415(c)(6)).

CURRENT CALIFORNIA LAW (Sec. 17501)

California conforms to the federal law prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 415(c)(6))

The special dollar limitation for annual additions to an ESOP is repealed.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The repeal is effective for years beginning after July 12, 1989.

IMPACT ON CALIFORNIA REVENUE

Based on nation estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $1 million range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIC: EMPLOYEE BENEFIT PROVISIONS

ACTION: EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs); REPEAL RELIEF FROM NET OPERATING LOSS PROVISIONS

ACT SECTION: 7304(d)

PRIOR FEDERAL LAW (IRC Sec. 382)

In general, if there is more than a 50 percent change in the ownership of a corporation that has net operating losses, the use of the corporation's pre-change losses and credits is limited following that ownership change. Employer securities acquired by certain ESOPs are not taken into account in determining whether an ownership change as occurred (Sec. 382(l)(3)(C)).

CURRENT CALIFORNIA LAW (Sec. 17321, 24592)

California conforms to the federal law prior to the 1989 OBRA changes.

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

The Act repeals the provision providing that certain employer securities are not taken into account in determining whether an ownership change has occurred for purposes of the net operating loss rules.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The repeal is effective for acquisitions of employer securities after July 12, 1989, other than acquisitions pursuant to a binding written contract in effect on July 12, 1989, and at all times thereafter before such acquisitions.

IMPACT ON CALIFORNIA REVENUE

Based on nation estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be minor, in the $100,000 range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIC: EMPLOYEE BENEFIT PROVISIONS

ACTION: CODIFY ADMINISTRATIVE REGULATIONS ALLOWING A DEFINED BENEFIT PENSION PLAN TO PROVIDE A CERTAIN AMOUNT OF MEDICAL BENEFITS

ACT SECTION: 7311

PRIOR FEDERAL LAW (IRC Sec. 401(h))

A defined benefit pension plan may provide medical benefits to retirees through a separate account that is part of the plan (a Section 401(h) account). These medical benefits, when added to any life insurance protection provided under the plan, are required to be incidental or subordinate to the retirement benefits provided under the plan.

Under Treasury regulations, the medical benefits are considered incidental or subordinate on the retirement benefits if, at all times, the aggregate of employer contributions (made after the date on which the plan first included such medical benefits) to provide such medical benefits and any life insurance protection does not exceed 25 percent of the aggregate pension contributions made after such date, other than contributions to fund past service credits. The IRS has taken the position that the 25 percent limitations may be applied based on plan cost rather than actual contributions.

CURRENT CALIFORNIA LAW (Sec. 17501)

California law is conformed to the federal provisions prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 401(h))

The Act codifies the 25 percent rule relating to whether retiree medical benefits are incidental or subordinate and requires that this determination be made on the basis of actual contributions to the plan rather than on plan costs.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for contributions after October 3, 1989. However the provision does not apply to contributions made to a Section 401(h) account on or before December 31, 1989, if:

(1) before October 3, 1989, the employer requested a private letter ruling or determination letter with respect to the qualification of the plan containing the Section 401(h) account or the deductibility of contributions to the account;

(2) the request sets forth that the method by which the plan meets the subordination requirement is based upon cost rather than upon actual contributions;

(3) the method under which such contributions are to be determined is permissible under Section 401(h) as interpreted by General Counsel Memorandum 39785; and

(4) on or before October 3, 1989, the Internal Revenue Service issued a private letter ruling, determination letter, or other letter providing that the plan including the account is qualified under Section 401(a) or that the contributions to the account are deductible, or acknowledging that the account would not adversely affect the qualified status of the particular plan, contingent on all phases of the plan being approved.

IMPACT ON CALIFORNIA REVENUE

Based on nation estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $5 to $7 million range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VII: FOREIGN PROVISIONS

ACTION: IMPROVES INFORMATION REPORTING REQUIREMENTS FOR CERTAIN U.S. FOREIGN OWNED CORPORATIONS

ACT SECTION: 7403

PRIOR FEDERAL LAW (IRC Sec. 6038A)

Any corporation (U.S. or foreign) that conducts a trade or business in the United States and that is 50 percent owned by a foreign person is required to file an information return reporting all transactions with related foreign persons (Sec. 6038A). Relatedness for this purpose is defined within the meaning of Sections 267(b), 707(b)(1), or 482. Noncompliance with the reporting requirements of Section 6038A is sanctioned by an initial penalty of $1000, plus additional $1000 penalties (maximum $24,000) for each 30-day period that the failure remains outstanding.

REASON FOR CHANGE

In order to determine whether adjustments are appropriate in the course of a tax audit of a U.S. taxpayer controlled by a foreign person, it may be necessary for the IRS to examine books, records, or other information in the custody of the the foreign corporation. Summonses for requested material have been enforced in U.S. courts against a foreign parent via its U.S. subsidiary. However, an obstacle in obtaining requested information is that standards of record keeping and document preservation vary from country to country. Most record keeping and document preservation standards are not as high as those imposed on U.S. taxpayers.

Accordingly, documents or material summoned from foreign parties may not exist by the time a summons is enforced, thus impeding the ability of the IRS to distribute, apportion, or allocate gross income, deductions, credits, or allowances among related organizations.

CURRENT CALIFORNIA LAW (Sec. 25111)

California law does not conform to the IRC provision, but does require taxpayers to retain and make available, upon request, the information return filed with the Internal Revenue Service.

NEW FEDERAL LAW (Sec. 6038A)

The Act expands the scope of the reporting requirements, adds a U.S. record maintenance requirement, enhances the enforceability of IRS summonses, and modifies penalties for noncompliance.

REVENUE RECONCILIATION ACT OF 1989

Reporting Requirements:

Expands the class of corporations subject to reporting under Section 6038A to include corporations with at least one 25 percent foreign shareholder, and expands the class of persons treated as related (with whom transactions are therefore reportable) to include 25 percent foreign shareholders.

Record Keeping:

Provides that each reporting corporation shall maintain records that pertain to reportable transactions as prescribed by regulations.

Summonses:

A related foreign person is required to designate the reporting corporation or another U.S. person as its agent to receive IRS summonses in connection with reportable transactions. The designation of a U.S. agent by a related foreign party applies solely for purposes of IRS summonses and does not apply for any other purpose under federal or state laws.

Judicial Proceedings:

The Act permits prompt judicial review of a summons (waiving the sovereign immunity and anti-injunction act defense that would generally bar such review). Thus, permits a person receiving a summons related to reporting of information to petition a federal court to quash the summons within 90 days after the summons is mailed. In the event that a petition to quash is filed timely, the statue of limitations on the taxable year(s) at issue are suspended during the judicial proceeding to quash the summon, and will expire 90 days after the conclusion of such judicial action.

Sanctions:

Increases the existing $1,000 penalty to $10,000, and increases each addition to that penalty from $1,000 to $10,000. The $24,000 ceiling on such additional penalty is repealed.

In the case of a failure to designate a U.S. agent to accept service of process, or failure to comply with a summons pertaining to a reportable transaction, the act provides for the IRS to allow deductions and cost of goods sold in accordance with determinations made, in its sole discretion, from its own knowledge or from such information as it may obtain through testimony or otherwise.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions are effective for taxable years of reporting corporations beginning after July 10, 1989.

REVENUE RECONCILIATION ACT OF 1989

IMPACT ON CALIFORNIA REVENUE

Unknown.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: LIMIT LIKE-KIND EXCHANGES BETWEEN RELATED PERSONS

ACT SECTION: 7601

PRIOR FEDERAL LAW (IRC Sec. 1031)

Gains from exchanges of property are generally recognized for tax purposes. However, some types of exchanges do not give rise to a taxable gain or deductible loss:

Property eligible for tax-free exchanges:

No gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a "like-kind" which is to be held either for productive use in a trade or business or for investment (Sec. 1031). The like-kind standard contrasts with the standard under Section 1033 providing for nonrecognition of gain upon certain involuntary conversions. Other than a condemnation of real estate (to which the like-kind standard applies under Section 1033(g)), Section 1033 permits nonrecognition of gain only if the taxpayer acquires replacement property that is "similar or related in service or use" to the converted property. This standard is significantly narrower than the like-kind standard. For example, unimproved and improved real estate generally are not considered similar or related in service or use.

Related party exchanges:

If related parties engage in a like-kind exchange, tax basis is shifted between properties, which may result in the reduction of tax upon the subsequent disposition of a property. There are no rules under present law with respect to these types of transactions.

Holding period requirements:

In order to qualify for nonrecognition treatment under section 1031, both the property exchanged and the property received must be held either for productive use in a trade or business or for investment. In Bolker v. Commissioner, the Ninth Circuit held that these holding requirements were met where the taxpayer received property in the liquidation of a corporation and exchanged it shortly thereafter for like-kind property. However, in Rev. Rul. 77-337, the IRS reached a contrary conclusion under similar facts.

REVENUE RECONCILIATION ACT OF 1989

CURRENT CALIFORNIA LAW (Sec. 18031, 18043, 24941)

For individuals, current California law (Sec. 18031) is in conformity with prior federal law by reference.

For banks and corporations, current California law (Sec. 24941) is in conformity with prior federal law, except with respect to exchanges of U.S. obligations.

REASON FOR CHANGE

The tax court holding and the contrary IRS ruling on the holding period has created uncertainty for Section 1031 property.

A like-kind transaction results in the substitution of basis, by allowing (related party) transactions to engage in like-kind exchanges of high basis property for low basis property in anticipation of selling the low basis property to avoid or reduce recognition of gain on the subsequent sale. Basis shifting can also be used to accelerate a loss on retained property. The like-kind standard as applied to exchanges of property is too broad and allows for the exploitation of tax codes.

NEW FEDERAL LAW (IRC Sec. 1031)

The new federal law provides that nonrecognition under Section 1031 is conformed to the standards of Section 1033(g) (nonrecognition on involuntary conversion). In order to qualify for nonrecognition treatment under Sections 1031 or 1033(g), the properties involved must be similar or related in service or use. In addition, foreign real property and U.S real property shall not be considered like-kind property under Section 1031. However, this rule does not apply for purposes of Section 1033(g), or Section 932 (Tax treatment of U.S. and Virgin Island residents).

The new federal law provides that if a taxpayer directly or indirectly exchanges property with a related party in a Section 1031 exchange, and within one year either the related party or the taxpayer disposes of the property, the original exchange will not qualify for nonrecognition under Section 1033. In addition, if the exchanged properties are disposed of prior to the one year holding period, both parties must recompute any gain from the date of the exchange. The disposition of Section 1031 property due to death of a trading taxpayer or involuntary conversion of traded property will not cause a recapture of taxes under Section 1033.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The like-kind exchange provisions apply to transfers occurring after July 10, 1989, and for tax years ending after July 10, 1989. The new provisions do not apply to any transfer made pursuant to a written binding contract, which was in effect on July 10, 1989.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates as developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $7 million range for 1990-91, decreasing to the $5 million range thereafter. The foreign/U.S. real property component of these estimates is minor, less than one-half million annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: SIMPLIFY COMPUTATION OF DEPRECIATION FOR PURPOSES OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS

ACT SECTION: 7611(a)

BACKGROUND

The Tax Reform Act of 1986 repealed the former preference tax and replaced it with a new Alternative Minimum Tax (AMT) similar to that which is imposed on individuals. One of the most significant and controversial elements of the new AMT system was the concept of comparing book income to taxable income (as modified for purposes of AMT) and increasing alternative minimum taxable income (AMTI) by a portion of any excess book income. The 1986 Act provided that after three years the book income adjustments (IRC Sec. 56(f)) would be replaced by a series of adjustments to current earnings (IRC Sec. 56(g)).

For taxable (income) years 1987, 1988, and 1989, 50 percent of the excess book income was added to AMTI.

For taxable (income) years beginning on or after January 1, 1990, 75 percent of the excess current earnings is added to AMTI.

PRIOR FEDERAL LAW (IRC Sec. 56(g)(4)(A))

Adjustments to current earnings, with respect to depreciation, include the following:

> For property placed in service on or after January 1, 1989, depreciation shall be determined under whichever of the following methods yields deductions with the smaller present value:
>
> (1) deductions computed under IRC Sec. 168(g), the alternative depreciation system, or
>
> (2) deductions determined under the method used for book purposes.
>
> For property placed in service from 1981 through 1988, depreciation shall be determined under whichever of the following methods yields deductions with the smaller present value:

(1) taking into account the adjusted basis of the property at the end of the last taxable year beginning before 1990 and allowing only straight-line depreciation over the remainder of the recovery period that would apply under IRC Sec. 168(g).

(2) deductions determined under the method used for book purposes.

For property placed in service prior to 1981, no adjustment is required.

CURRENT CALIFORNIA LAW (Sec. 23400, 23456)

California law is conformed to federal law by reference except that, for property placed in service from 1981 through 1986, the deduction is limited to the straight-line method of computing depreciation.

NEW FEDERAL LAW (IRC Sec. 56(g)(4)(A))

The comparison to the method used for book purposes is repealed.

For property placed in service on or after January 1, 1989, depreciation shall be determined under IRC Sec. 168(g), the alternative depreciation system.

For property placed in service from 1981 through 1988, depreciation shall be determined by taking into account the adjusted basis of the property at the end of the last taxable year beginning before 1990 and allowing only straight-line depreciation over the remainder of the recovery period that would apply under IRC Sec. 168(g).

EFFECTIVE DATE OF FEDERAL PROVISIONS

Taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Not applicable. Depreciation allowances under the Bank and Corporation Tax Law for regular tax and AMT purposes have deliberately deviated from federal law.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: REVISION OF EARNINGS AND PROFITS ADJUSTMENTS FOR PURPOSES OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS

ACT SECTION: 7611(b)

PRIOR FEDERAL LAW (IRC Sec. 56(g)(4)(D))

The provisions of IRC Sec. 312(n), relating to adjustments to earnings and profits to more accurately reflect economic gain and loss, are made applicable for purposes of computing AMTI, with some modifications. The individual items are:

Construction Period Carrying Costs:

Expenditures must be capitalized and added to the basis of the property. No amortization is permitted.

Intangible Drilling Costs:

Expenditures must be capitalized and amortized over 60 months beginning with the month in which production begins. If the method used for determining book income would result in a lower present value of the deductions, then the book income method must be used.

Mineral Exploration and Development Costs:

Expenditures must be capitalized and amortized over 120 months beginning with the later of:

(1) the month in which production begins, or

(2) the month in which the expenditure is paid or incurred.

If the method used for determining book income would result in a lower present value of the deductions, then the book income method must be used.

Circulation Expenditures:

Expenditures must be capitalized and cannot be amortized over 36 months as permitted for regular tax purposes.

Organizational Expenditures:

Expenditures must be capitalized and cannot be amortized over 60 months as permitted for regular tax purposes.

REVENUE RECONCILIATION ACT OF 1989

LIFO Inventory:

If inventory is valued using the FIFO method, the cost of goods sold must be reduced by any excess value over using the LIFO method to value the inventory.

Installment Sales:

The installment method is not permitted.

Long-Term Contracts:

The percentage of completion method is required to be used for the entire amount of the contract.

CURRENT CALIFORNIA LAW (Sec. 23400, 23456)

California law is conformed by reference to federal law. There are no exceptions.

NEW FEDERAL LAW (IRC Sec. 56(g)(4)(D))

The general provisions of IRC Sec. 312(n) are no longer made applicable by reference to that section. However, many of those rules are incorporated into IRC Sec. 56(g)(4)(D).

Construction Period Carrying Costs:

Repealed. Expenditures may be deducted to the extent allowed for regular tax purposes.

Intangible Drilling Costs:

Retained, but no comparison to book income method. Expenditures must be capitalized and amortized over 60 months beginning with the month in which such amount was paid or incurred.

Mineral Exploration and Development Costs:

Repealed. Expenditures must be capitalized and amortized over 10 years beginning with the year in which such expenditure was made (same as regular tax).

Circulation Expenditures:

Retained. Expenditures must be capitalized and cannot be amortized over 36 months as permitted for regular tax purposes.

REVENUE RECONCILIATION ACT OF 1989

Organizational Expenditures:

Retained. Expenditures must be capitalized and cannot be amortized over 60 months as permitted for regular tax purposes.

LIFO Inventory:

Retained. If inventory is valued using the FIFO method, the cost of goods sold must be reduced by any excess value over using the LIFO method to value the inventory.

Installment Sales:

Retained. In general, the installment method may not be used in computing AMTI. However, the installment method may be used for sales on which the taxpayer is paying interest charges for the deferral of tax under IRC Sec. 453A(a)(1).

Long-Term Contracts:

Repealed. The percentage of completion method is now required to be used for the entire amount of the contract for regular tax purposes. Thus, an adjustment for AMT is no longer necessary.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Taxable years beginning on or after January 1, 1990.

For intangible drilling costs, the amendments apply to costs paid or incurred in taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates for elimination of book backstop provisions, state revenue losses for applicable provisions could amount to $10 million annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: SIMPLIFY COMPUTATION OF DEPLETION FOR PURPOSES OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS

ACT SECTION: 7611(c)

PRIOR FEDERAL LAW (IRC Sec. 56(g)(4)(G)

The allowance for depletion of property placed into service in a taxable year beginning on or after January 1, 1990, is determined under whichever of the following methods yields deductions with the smaller present value:

(1) Cost depletion determined under IRC Sec. 611, or

(2) The deduction determined under the method used for book purposes.

CURRENT CALIFORNIA LAW (Sec. 23400, 23456)

California law is conformed by reference to federal law. There are no exceptions.

NEW FEDERAL LAW (IRC Sec. 56(g)(4)(G))

The comparison to the method used for book purposes is repealed. The deduction is limited to the amount allowable as cost depletion determined under IRC Sec. 611.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Included in estimate for Act Section 7611(b) on book backstop repeals.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: SIMPLIFY COMPUTATION OF DIVIDENDS FOR PURPOSES OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS

ACT SECTION: 7611(d)

PRIOR FEDERAL LAW (IRC Sec. 56(g)(4)(C)(ii)

The only dividends-received deduction allowed for ACE is the 100-percent dividends-received deduction where the corporation receiving the dividend owns 80 percent of the payor corporation but is ineligible to file a consolidated return. The deduction is allowed only to the extent the earnings distributed were subject to tax.

CURRENT CALIFORNIA LAW (Sec. 23400, 23456(f)(1)(B))

Not applicable. Although conformed by reference to the general provisions of federal law, California law specifies that IRC Sec. 56(g)(4)(C)(ii) is not applicable for state purposes.

NEW FEDERAL LAW (IRC Sec. 56(g)(4)(C)(ii))

The new federal law allows the dividends received deduction under ACE for any dividend for which the dividends received deduction is 100 percent, to the extent the earnings were subject to tax.

The new federal law also allows the dividends received deduction under ACE to dividends received from a 20-percent owned corporation, to the extent the earnings were subject to tax.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Not applicable.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: SIMPLIFY COMPUTATION OF DIVIDENDS FOR PURPOSES OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS

ACT SECTION: 7611(e)

PRIOR FEDERAL LAW (IRC Sec. 56(g)(4)(C))

The dividends-received deduction is not allowed for dividends paid to a parent corporation out of earnings not subject to tax by reason of the foreign sales corporation rules.

CURRENT CALIFORNIA LAW (Sec. 23456(f)(1)(A))

Not applicable. Although conformed by reference to the general provisions of federal law, California law modifies federal law to substitute references to state provisions relating to the deduction of dividends.

NEW FEDERAL LAW (IRC Sec. 56(g)(4)(C)(iv))

The new federal law allows the dividends received deduction for dividends received from a foreign sales corporation by a qualified cooperative engaged in the marketing of agricultural or horticultural products.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Not applicable.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: MODIFY THE MINIMUM TAX CREDIT FOR CORPORATIONS

ACT SECTION: 7612(a)

BACKGROUND

Each taxpayer is required to compute taxable income for both regular tax purposes and for the alternative minimum tax. If the tax on AMTI (tentative minimum tax) exceeds the regular tax, the excess is imposed as the alternative minimum tax (added on to regular tax).

The 1986 Tax Reform Act added the minimum tax credit which was designed to allow a credit (against regular tax in future years) for a portion of the alternative minimum tax (attributable to deferral items). This approach was taken to avoid double taxation of deferral items, e.g., an installment sale taxed in full in the year of sale for alternative minimum tax purposes, but spread over several years for regular tax purposes would be included in AMTI twice, since the calculation of AMTI begins with the taxable income for regular tax purposes.

PRIOR FEDERAL LAW (IRC Sec. 53(d)(1))

A minimum tax credit is allowed for minimum tax attributable to deferral items.

CURRENT CALIFORNIA LAW (Sec. 17063, 23453)

California law is conformed by reference to federal law. There are no exceptions.

NEW FEDERAL LAW (IRC Sec. 53(d)(1))

The new federal law allows the minimum tax credit to corporations for the entire minimum tax liability.

For individuals, the credit is still be limited to the tax on deferral items.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Applies to determinations of adjusted minimum tax (amounts eligible for the credit) for taxable years beginning on or after January 1, 1990.

REVENUE RECONCILIATION ACT OF 1989

IMPACT ON CALIFORNIA REVENUE

The revenue loss for the first year would probably be in the $1 million range, increasing to $2 and $4 for the following two years.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: INCREASE MINIMUM TAX CREDIT BY ANY PORTION OF ORPHAN DRUG TAX CREDIT WHICH IS LIMITED BY TENTATIVE MINIMUM TAX

ACT SECTION: 7612(b)

PRIOR FEDERAL LAW (IRC Sec. 28(d)(2))

The orphan drug tax credit may not reduce a taxpayer's tax to less than the tentative minimum tax. No carryovers are permitted.

CURRENT CALIFORNIA LAW (Sec. 17039, 17057, 23036, 23609.5)

The orphan drug tax credit is a "qualified" credit that is permitted to reduce the regular tax below the tentative minimum tax.

California law also differs from federal law in that any portion of the orphan drug credit that exceeds the current year tax is allowed to be carried forward and applied against the tax in future years.

NEW FEDERAL LAW (IRC Sec. 53(d)(1)(B))

The new federal law increases the minimum tax credit by the amount of the orphan drug credit not allowed solely by reason of the tentative minimum tax limitation.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to taxable year beginning on or after January 1, 1990, with respect to credits disallowed in taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Not applicable.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: EXEMPTS HOME CONSTRUCTION CONTRACTS FROM THE ADJUSTMENTS MADE FOR PURPOSES OF ALTERNATIVE MINIMUM TAX

ACT SECTION: 7612(c)

PRIOR FEDERAL LAW (IRC Sec. 56(a)(3))

Small home construction contracts (average annual gross receipts of less than $10 million for the preceding three years) are excepted from the minimum tax rule requiring taxpayers to use the percentage of completion method of accounting.

CURRENT CALIFORNIA LAW (Sec. 17062, 23400, 23456)

California law is conformed by reference to federal law. There are no exceptions.

NEW FEDERAL LAW (IRC Sec. 56(a)(3))

The new federal law exempts all home construction contracts from the minimum tax rule.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision is effective for contracts entered into after September 30, 1990.

IMPACT ON CALIFORNIA REVENUE

Revenue losses could amount to the $1 million range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF, PART II: MINIMUM TAX PROVISIONS

ACTION: EXEMPTS CERTAIN RESEARCH EXPENSES OF INDIVIDUALS FROM THE ADJUSTMENTS MADE FOR PURPOSES OF ALTERNATIVE MINIMUM TAX

ACT SECTION: 7612(d)

PRIOR FEDERAL LAW (IRC Sec. 56(b)(2))

Research expenses of individuals must be amortized over a 10-year period for purposes of the minimum tax.

CURRENT CALIFORNIA LAW (Sec. 17062)

California law is conformed by reference to federal law. There are no exceptions.

NEW FEDERAL LAW (IRC Sec. 56(b)(2)(D))

The new federal law repeals the minimum tax adjustment for research expenses of individuals who materially participate in the activity in which research expenses are incurred.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Taxable years beginning on or after January 1, 1991.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates, comparable state revenue losses would be in the $1 million range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: ACCOUNTING PROVISIONS

ACTION: REPEAL COMPLETED CONTRACT METHOD

ACT SECTION: 7621

PRIOR FEDERAL LAW (IRC Sec. 460)

Taxpayers engaged in the production of property under a long term contract generally must compute income from the contract under either the percentage of completion method or the percentage of completion-capitalized cost method. However, exceptions to these required accounting methods are provided for certain construction contracts of small businesses and certain home construction contracts.

Under the percentage of completion method, a taxpayer must include in gross income for any taxable year an amount that is based on the product of (1) the gross contract price and (2) the percentage of the contract completed as of the end of the taxable year. The percentage of the contract completed as of the end of a taxable year is determined by comparing costs incurred with respect to the contract as of the end of the year with the estimated total contract costs. In addition, under the percentage of completion method, costs allocable to the contract generally are taken into account for the taxable year in which incurred.

Under the percentage of completion-capitalized cost method, a taxpayer generally must take into account 90 percent of the items under the contract under the percentage of completion method. The remaining 10 percent of the items under the contract must be taken into account under the taxpayer's normal method of accounting (e.g., the completed contract method of accounting). Exceptions to the 90/10 requirement are provided for certain ship construction contracts (40 percent under the percentage of completion method and 60 percent under the taxpayer's normal method of accounting) and certain residential construction contracts other than home construction contracts (70 percent under the percentage of completion method and 30 percent under the taxpayer's normal method of accounting).

CURRENT CALIFORNIA LAW (Sec. 17564, 24673.2)

California conformed to the basic adoption of the percentage of completion-capitalized cost method of accounting (as an alternative to the percentage of completion method) made by the 1986 Tax Reform Act which requires 40 percent of the contract to be accounted for under the percentage-of-completion method and the other 60 percent to be accounted for under the taxpayer's normal method of accounting (normally the completed contract method). California has not, as yet, conformed to requirements enacted in the 1987 Revenue Act which increased from 40 percent to 70 percent the amount of the contract which must be accounted for under the percentage of completion method. In addition, to date, the California law has not been conformed to the subsequent increase (from 70 percent to 90 percent) made by the 1988 Technical and Miscellaneous Revenue Act.

NEW FEDERAL LAW (IRC Sec. 460)

The Act repeals the percentage of completion-capitalized cost method of accounting for long-term contracts. The present-law special rules and exceptions for certain construction contracts of small businesses, qualified ship contracts, home construction contracts and residential construction contracts are retained.

For purposes of the percentage of completion method of accounting, a taxpayer may elect not to recognize income under a long-term contract and not to take into account any costs allocable to such long-term contract for any taxable year if as of the end of the taxable year less than 10 percent of the estimated total contract costs have been incurred. For the first taxable year in which the 10 percent threshold is satisfied, all costs that have been incurred as of the end of the taxable year are to be taken into account in determining the percentage of the contract that has been completed and in determining the amount of allowable deductions under the contract.

The election of the 10 percent method is to apply for purposes of the look-back method, in determining alternative minimum taxable income, and in determining adjusted current earnings under the alternative minimum tax. The election of the 10 percent method is not to apply, however, in determining whether an item normally requires more than 12 calendar months to complete for purposes of the definition of a long-term contract or in determining the production period for the allocation of interest.

The election of the 10 percent method is to apply to all long-term contracts of a taxpayer that are entered into during the taxable year that the election is made any subsequent taxable year that the election is in effect. The election of the 10 percent method, however, is not to apply to any long-term contract with respect to which the percentage of completion method of accounting is used only with respect to a portion of the items under the contract or with respect to which a simplified method of cost allocation is used. Once made, the election of the 10 percent method may be revoked only with the consent of the Secretary of the Treasury.

REVENUE RECONCILIATION ACT OF 1989

In order to prevent taxpayers from unreasonably deferring income by reason of the election, the present-law rules which authorize the Internal Revenue Service to treat one agreement as several contracts or to treat several agreements as one contract are to apply.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to contracts entered into on or after July 11, 1989. However, the provision does not apply to any contract entered into pursuant to a written bid or proposal submitted by a taxpayer to the other party to the contract before July 11, 1989, if the bid or proposal could not have been revoked or amended by the taxpayer at any time during the period after July 10, 1989, and ending on the date that the contract was entered into.

The conference report indicates that the election of the 10 percent method is to apply only to contracts that are entered into after December 31, 1989, however, no such language is included in the Act section.

IMPACT ON CALIFORNIA REVENUE

On an income year basis, increasing the state's required percentage of completion component from the current 40% to 100% would increase revenues by $47 million for 1990, $78 million for 1991, $92 million for 1992, and $45 million for 1993. The 10% exception rule would reduce these revenues by perhaps $2 million annually. These estimates are based on previous analyses on raising the state percentage above 40% as well as current national estimates on (a) a 100% standard for percentage of completion purposes and (b) the effects of the 10% election.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: ACCOUNTING PROVISIONS

ACTION: MODIFY TREATMENT OF FRANCHISE, TRADEMARK AND TRADE NAME EXPENSES

ACT SECTION: 7622

PRIOR FEDERAL LAW (IRC Sec. 167, 1245, 1253)

A taxpayer that purchases an intangible asset (such as a patent, know-how, or a contract right) generally is allowed to deduct the purchase price over a period no shorter than the useful life of the asset. If the life is not determinable or is perpetual, no deduction generally is permitted. The useful life of an asset is a question of fact.

In the case of certain payments made on account of the transfer of a franchise, trademark, or trade name, special rules apply. For example, in the case of a single payment made in discharge of a fixed-sum amount where the transferor is required to treat the payment as ordinary income rather than as capital gain, the payment by the transferee is deductible ratably over a period of no more than 30 taxable years. In addition, any amount that is contingent on the productivity, use, or disposition of the franchise, trademark, or trade name is allowed as an ordinary and necessary business expense deduction.

Generally, amounts allowed as a deduction that reduce the basis of assets are recaptured as ordinary income if the asset is disposed of for an amount in excess of the reduced basis. It is unclear whether deductions allowed with respect to certain payments made to acquire a franchise, trademark, or trade name are required to be recaptured as ordinary income on the disposition of the franchise, trademark, or trade name.

No depreciation or amortization deduction is permitted for expenditures relating to the acquisition of a trademark or trade name. In addition, several courts have held that the cost of creating or acquiring a trademark or trade name is not amortizable on the grounds that a trademark or trade name is indistinguishable from goodwill and generally does not have a determinable useful life.

CURRENT CALIFORNIA LAW (Sec. 17201, 18151, 24349-24356, 24990)

California law is conformed to federal law prior to the 1989 OBRA changes.

REVENUE RECONCILIATION ACT OF 1989

NEW FEDERAL LAW (IRC Sec. 167, 1245, 1253)

The Act modifies the special rules that apply to the deduction of fixed-sum payments and contingent payments that are made on account of the transfer of a franchise, trademark, or trade name.

First, the Act repeals the special treatment accorded payments in discharge of a fixed-sum amount where the fixed-sum amount for any transaction exceeds $100,000. This repeal applies regardless of whether the payments are made to a franchisor that is required to treat the payments as ordinary income or to any other person. For purposes of determining whether the $100,000 threshold has been exceeded, all payments that are part of the same transaction (or a series of related transactions) are aggregated.

Second, a deduction is allowed for contingent amounts only if (1) the contingent amounts are paid as part of a series of payments that are payable at least annually throughout the term of the transfer agreement, and (2) the payments are substantially equal in amount or are payable under a fixed formula. The conference report indicates that, for this purpose, a fixed formula generally includes a formula that provides for payments of a percentage of the annual gross receipts of the transferee (whether a single percentage of annual gross receipts or a series of percentages that apply each year to annual gross receipts up to or in excess of specified levels of gross receipts for each year) but only if the formula does not vary for any year of the transfer agreement. A fixed formula, however, does not include any formula that is likely to, or could potentially, distort the taxable income of the transferee either by front-loading or back loading the contingent payments.

Any fixed-sum or contingent amount that is not deductible under the foregoing rules is chargeable to capital account and is to be amortized over the useful life of the franchise, trademark, or trade name, to the extent otherwise allowed under present law.

However, a taxpayer may elect to amortize certain fixed-sum payments and contingent payments that are chargeable to capital account and that are part of the same transaction (or series of related transactions) over a 25-year period that begins with the taxable year in which the transfer occurs. This election applies only with respect to payments that are otherwise described in Section 1253 but that no longer qualify for a 10-year write-off or a current contingent payment deduction under that section as amended by the provision. As under present law, other expenditures with respect to franchises, trademarks, or trade names are not afforded any elective treatment.

The Act also provides that fixed-sum amounts that are allowed as a deduction are subject to recapture as ordinary income on disposition of the franchise, trademark, or trade name.

Finally, the Act repeals the provision of present law that prohibits a deduction for the cost of acquiring a trademark or trade name.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to transfers that occur after October 2, 1989, unless pursuant to a binding written contract in effect on that date and at all times thereafter until the transfer occurs.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $7 million range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: LIMIT THE EXCLUSION OF COMPENSATION FOR INJURIES OR SICKNESS

ACT SECTION: 7641

PRIOR FEDERAL LAW (IRC Sec. 104(a))

Under federal law, damages received on account of personal injury are excludable from gross income. In some cases, courts have held that this exclusion is available even though there is no physical injury.

CURRENT CALIFORNIA LAW (Sec. 17131)

California law is conformed to federal law by reference.

REASON FOR CHANGE

This exclusion from gross income was not intended to be applied to punitive damages in cases not involving physical injury or sickness (i.e., discriminatory and labor awards).

NEW FEDERAL LAW (IRC Sec. 104(a))

Under the new federal law, the exclusion for damages received for personal injury is limited to cases involving physical injury or sickness.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new federal law applies to punitive damages received after July 10, 1989, other than amounts received under a written binding agreement, court decree, or mediation award in effect on or issued before July 10, 1989, or amounts received pursuant to suits filed on or before July 10, 1989.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $250,000 range annually.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: RECOGNIZE GAIN ON DISTRIBUTION OF CONTRIBUTED PROPERTY BY A PARTNERSHIP

ACT SECTION: 7642

PRIOR FEDERAL LAW (IRC Sec. 704(c))

Income, gain, loss, and deduction with respect to property contributed to a partnership by a partner is required to be shared among partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution. Thus, if appreciated property that was contributed to the partnership is sold by the partnership, gain recognized on the sale is required to be allocated to the contributing partner to the extent he/she has not previously taken the pre-contribution gain into account.

CURRENT CALIFORNIA LAW (Sec. 17851)

California law is conformed to federal law by reference.

REASON FOR CHANGE

A partner generally does not recognize gain on a distribution of partnership property (except on a distribution of money in excess of a partner's basis in his partnership interest). Thus, if appreciated property that was contributed by a partner is distributed to other partners (rather than sold by the partnership), the contributing partner may avoid recognizing the pre-contribution gain.

NEW FEDERAL LAW (IRC Sec. 704(c))

The new federal law provides that, in the case of a distribution of contributed property, the contributing partner is treated as recognizing gain or loss. However, gain or loss is not recognized to the extent partnership property of a like-kind is distributed to the partner who originally contributed the property to the partnership. The offsetting transfer of like-kind property must be completed within 5 years following the time of the original contributed property. When gain or loss recognition is required under the new federal law, the amount the contributing partner is treated as recognizing is equal to the variation between basis and value of the contributed property, had the property been sold by the partnership at its fair market value at the time of the distribution.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new federal law applies to property contributed to a partnership after October 3, 1989.

IMPACT ON CALIFORNIA REVENUE

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

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: LIMIT ACCELERATED DEPRECIATION OF CELLULAR TELEPHONES

ACT SECTION: 7643

PRIOR FEDERAL LAW (IRC. Sec. 280F(d)(4)(A))

Under federal law, special rules apply to costs incurred to purchase or lease of certain listed property that is used in a trade or business:

1) If the listed property is placed in service and the use of the property for trade or business purposes does not exceed 50 percent of the total use of the property, then the depreciation deduction with respect to such property is determined under the alternative depreciation system. The alternative depreciation system generally requires the use of the straight-line method of depreciation over a longer period of time.

2) If an individual owns or leases listed property that is used by the individual in connection with the performance of services as an employee, no depreciation deduction, expensing allowance, or deduction for lease payments is allowed unless the use of the property is for the convenience of the employer and is required as a condition of employment.

3) No deduction is allowed with respect to listed property unless the taxpayer maintains adequate records or provides other sufficient evidence that establishes the amount of business use, investment use, and personal use of the listed property.

Listed property is defined as:

(1) any passenger automobile; (2) any other property used as a means of transportation; (3) any property of a type generally used for purposes of entertainment, recreation, or amusement; (4) any computer or peripheral equipment; and (5) any other property of a type specified in Treasury regulations.

CURRENT CALIFORNIA LAW (Sec. 17201, 24349.1)

California law is conformed to federal law by reference.

REVENUE RECONCILIATION ACT OF 1989

REASON FOR CHANGE

Many taxpayers claim accelerated depreciation with respect to cellular telephones and other similar telecommunications equipment, which was purchased primarily for personal or investment use, rather than in the conduct of a trade or business. The intent of the accelerated depreciation provision is to encourage investment in new plant and equipment rather than to subsidize the purchase of personal property that is used incidentally or occasionally in a trade or business.

NEW FEDERAL LAW (IRC Sec. 280F(d)(4)(A))

The new federal law expands the definition of listed property to include cellular telephones and other similar telecommunications equipment.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new federal law applies to property leased or placed in service in taxable years beginning on or after January 1, 1990.

IMPACT ON CALIFORNIA REVENUE

Based on national estimates developed by the Joint Committee on Taxation, comparable state revenue gains would be in the $500,000 range for 1990, increasing to the $1 million range by 1993.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: DISALLOW DEPRECIATION DEDUCTION FOR A TERM INTEREST IN PROPERTY HELD BY A RELATED PERSON

ACT SECTION: 7645

PRIOR FEDERAL LAW (IRC Sec. 167)

The purchaser of a term interest in property is, for income tax purposes, generally entitled to amortize the cost of the interest over its expected life. On the other hand, the tax courts have held that a person who divides an interest in property into temporal interests cannot create an amortizable asset where none previously existed. (Lomas Santa Fe, Inc. v. Commissioner, 74 T.C. 662, 682-83 (1980)). Nor can the holder of a life or terminable interest acquired by gift, bequest or inheritance amortize his interest (IRC Sec. 273). In the case of property held by one person for life with remainder to another, the life tenant is allowed a depreciation deduction computed as if he were the absolute owner of the property.

CURRENT CALIFORNIA LAW (Sec. 17201, 24349-24356)

California law is conformed to federal law (no provision).

REASON FOR CHANGE

A common method of deferring income tax is for two related persons to jointly purchase a term and remainder interest in property. Typically, a parent will purchase an income interest in property (including stocks and real estate) while, at the same time, a child purchases the remainder interest of the same property. Under present law, the parent can reduce taxable income from the term property by the amortization deduction of the cost of the term interest. The child will recognize a gain when the property is sold or exchanged. The deferral implicit in a joint purchase results from the fact that the remainderman is not taxed currently on the increase in value of the interest.

NEW FEDERAL LAW (IRC Sec. 167(r))

Under the new federal law, no depreciation or amortization deduction is allowed for a term interest in property for any period during which the remainder interest in such property is held (directly or indirectly) by a related person. A term interest in property means a life interest in property, an interest in property for a term of years, or an income interest in a trust.

In addition, the taxpayer's basis in a term interest is reduced by the deductions disallowed by the new provision, and the remainderman's basis in the remainder is increased by the amount of disallowed deductions. The remainderman's basis in the remainder is not increased for any disallowed deductions attributable to periods during which the term interest was held by an organization exempt from tax under subtitle A of the Code or a nonresident alien individual, or foreign corporation (but only if income from the term interest is not effectively connected with the conduct of a trade or business in the United States).

The holder of an interest in property for a term of years whose amortization deduction would be allowed but, under the provision is permitted a depreciation deduction and computed as if he were absolute owner of the property. Thus, the provision does not allow such a depreciation deduction to a person whose amortization deduction is disallowed under present law. An increase in the remainderman's basis in his interest is reduced by any depreciation allowable to the term holder with respect to the underlying property. The provision does not apply to any term interest to which Section 273 applies. In addition, the remainderman's basis in the property is increased only if the term holder's amortization deduction would be allowed.

The federal conference report stated that there is no inference regarding the divisibility of property for tax purposes under present law, nor is there any inference regarding the character of income or gain from property.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new federal law applies to interests acquired or created after July 27, 1989.

IMPACT ON CALIFORNIA REVENUE

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

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: INFORMATION REPORTING OF POINTS ON MORTGAGE LOANS

ACT SECTION: 7646

PRIOR FEDERAL LAW (IRC Sec. 6050H)

Any person who, in the course of a trade or business during a calendar year, receives from an individual $600 or more of interest on an obligation secured by real property must file an information return with the Internal Revenue Service and must provide a copy of that return to the payor. The information return generally must include the name, address, and taxpayer identification number of the individual from whom the interest was received and the amount of the interest received for the calendar year. Treasury regulations (Sec. 1.6050H-1(e)) provide that points are not to be treated as interest for purposes of this reporting requirement.

CURRENT CALIFORNIA LAW (Sec. 18802.6)

California law is conformed to federal law by reference.

REASON FOR CHANGE

The inclusion of the amount of points paid directly by a borrower on the information return will improve the ability of the IRS to enforce present law rules relating to the treatment of points for income tax purposes. In addition, the provision requiring that a copy of the information return be provided to the payor of the points will assist taxpayers in complying with present law.

NEW FEDERAL LAW (IRC Sec. 6050H)

The bill provides that any person required to file an information return with respect to mortgage interest must include on such return the amount of points received on the mortgage during the calendar year and indicate whether the points were paid directly by the borrower (as opposed to being withheld from the loan disbursement).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new federal law applies to statements and returns with due dates which (determined without regard to extensions) is after December 31, 1991.

REVENUE RECONCILIATION ACT OF 1989

IMPACT ON CALIFORNIA REVENUE

National estimates of revenue gains are only $5 million annually; comparable state revenue gains would be negligible and would most likely occur irrespective of conformity legislation.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIF: MISCELLANEOUS PROVISIONS

ACTION: EXPAND RESTRICTIONS ON INVESTMENT ORIENTED LIFE INSURANCE

ACT SECTION: 7647

PRIOR FEDERAL LAW (IRC Sec. 7702A)

In order to discourage the purchase of life insurance as a tax sheltered investment vehicle, the Technical and Miscellaneous Revenue Act of 1988 altered the Federal income tax treatment of loans and other amounts received under a class of life insurance contracts that are statutorily defined as "modified endowment contracts".

A modified endowment contract generally is defined as any contract that satisfies the definition of a life insurance contract but fails to satisfy a 7-pay test. A contract fails to satisfy the 7-pay test if the cumulative amount paid under the contract at any time during the first 7 contract years exceeds the sum of the net level premiums that would have been paid on or before such time had the contract provided for paid-up benefits after the payment of 7 level annual premiums.

REASON FOR CHANGE

In order to discourage the issuance of investment-oriented life insurance, Congress has expanded the scope of the "modified endowment contract" definition to include so called "last to die" or "last survivor" life insurance contracts.

CURRENT CALIFORNIA LAW (Sec. 17020.6, 23045)

California law is in conformity with federal law prior to the 1989 OBRA changes.

NEW FEDERAL LAW (IRC Sec. 7702A)

In the case of any contract that qualifies as a life insurance contract and that provides a death benefit that is payable only upon the death of one insured following, or simultaneously with, the death of another insured, if there is any reduction in such death benefit below the lowest level of such death benefit provided under the contract for the first 7 contract years, the 7-pay test is to be applied for the first 7 contract years as if the contract had originally been issued at the reduced death benefit.

If the contract fails to meet the 7-pay test, the contract is to be treated as a modified endowment contract for:

(1) distributions that occur during the contract year that the reduction in the death benefit occurs and during any subsequent contract year; and

(2) under Treasury regulations, distributions that occur in anticipation of the reduction in the death benefit. For this purpose, any distribution that is made within 2 years before the reduction in the death benefit is to be treated as made in anticipation of such reduction.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision applies to contracts that are entered into or that are materially changed on or after September 14, 1989.

IMPACT ON CALIFORNIA REVENUE

National estimates developed by the Joint Committee on Taxation indicate negligible gains: revenue gains under state conformity would not be significant.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: ESTABLISHES UNIFORM PENALTIES FOR FAILURE TO COMPLY WITH INFORMATION RETURN REPORTING REQUIREMENTS

ACT SECTION: 7711

BACKGROUND

In general, California has adopted counterparts to most federal penalties relating to information returns. At one time, the amount of any specific state penalty was generally 20% of the federal amount, based upon the approximate ratio of maximum tax rates (.11/.50). Such a ratio (20%) is no longer valid, since both state and federal maximum rates have been reduced. California's maximum rate is now approximately 1/3 of the federal rate (.093/.28).

In recent years, some of the state penalties have been increased to equal the federal amount.

PRIOR FEDERAL LAW

Failure to File Information Returns (IRC Sec. 6721, 6724)

Any person that fails to file an information return with the Internal Revenue Service on or before the prescribed filing date is subject to a $50 penalty for each failure, with a maximum penalty of $100,000 per calendar year.

Information returns relating to interest and dividends are subject to the $50 penalty for each failure, but without any cap on the total amount of penalty that may be imposed.

In cases of intentional disregard of the filing requirement, the penalty is increased to the greater of $100 per failure or 10 percent of the amount of income that is not reported. There is no maximum penalty amount in the case of intentional disregard of the rules.

Failure to Furnish Payee Statements (IRC Sec. 6722)

Any person that fails to provide a "payee statement" to a taxpayer on or before the prescribed due date is subject to a penalty of $50 for each failure, with a maximum penalty of $100,000 per calendar year.

A "payee statement" is a reporting (to the person who received a payment) of information that is being reported to the IRS by the payor. Usually, this consists of a copy of the information return.

Failure to Include the Correct Information (IRC Sec. 6723)

If a person fails to include all of the information required to be shown on an information return or a payee statement or includes incorrect information, then a penalty of $5 may be imposed with respect to each such failure, with a maximum penalty of $20,000 per calendar year.

In cases of intentional disregard of the filing requirement, the penalty is increased to the greater of $100 per failure or 10 percent of the amount of income that is not reported. There is no maximum penalty amount in the case of intentional disregard of the rules.

Failure to Include Taxpayer Identification Number (IRC Sec. 6676)

A penalty may also be imposed for each failure to include a correct taxpayer identification number on a return or statement and for each failure to furnish a correct taxpayer identification number to another person. The amount of the penalty that may be imposed is either $5 or $50 for each failure, depending on the nature of the failure with a maximum penalty of $100,000. In the case of interest or dividend income, the penalty is not subject to the $100,000 ceiling.

Failure to Provide Place of Residence (IRC Sec. 6017A, 6687)

A penalty may be imposed for each failure to include information with respect to place of residence. The amount of the penalty is $5 for each failure.

CURRENT CALIFORNIA LAW

Failure to File Information Returns (Sec. 18681.1(a), 18681.1(d))

California law is conformed to federal law by reference, including penalty amounts.

Failure to Furnish Payee Statements (Sec. 18681.1(b))

California law is conformed to federal law by reference, including penalty amounts.

Failure to Include the Correct Information (Sec. 18681.1(c))

California law is conformed to federal law by reference, including penalty amounts.

Failure to Include Taxpayer Identification Number (Sec. 18685.07)

California law follows federal law, except that the amount of the penalties are $5 or $10 (versus $5 or $50) with a maximum penalty of $20,000 (versus $100,000).

Failure to Provide Place of Residence (None)

California law does not include any provision similar to federal law.

REASON FOR CHANGE

The federal conference committee believed that the present law penalties should be modified to encourage persons to file correct information returns even though such returns are filed after the prescribed filing date. The committee believed that it is important to give taxpayers an incentive to correct their errors as rapidly as possible.

NEW FEDERAL LAW

Overview

The federal conference committee established a three-tier penalty structure in which the amount of the penalty varies with the length of time within which the taxpayer corrects the failure. The committee believed that the new structure would give taxpayers an incentive to correct their errors as rapidly as possible. The committee also provided that taxpayers may correct a de minimis number of errors and avoid penalties entirely.

Failure to File Correct Information Returns (IRC Sec. 6721)

Under the new federal law, any person that fails to file a correct information return with the Internal Revenue Service on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, the correct information return is filed.

> If a person files a correct information return after the prescribed filing date but on or before the date that is 30 days after the prescribed filing date, the amount of the penalty is $15 per return, with a maximum penalty of $75,000 per calendar year.
>
> If a person files a correct information return after the date that is after 30 days after the prescribed filing date but on or before August 1, the amount of the penalty is $30 per return, with a maximum penalty of $150,000 per calendar year.
>
> If a correct information return is not filed on or before August 1 of any year, the amount of the penalty is $50 per return, with a maximum penalty of $250,000 per calendar year.

The federal conference committee chose this initial 30-day period for filing correct information returns with a smaller penalty because it believed that it is vital to the integrity of the self-assessment system that taxpayers receive their payee statements on a timely basis (generally, these must be provided by January 31). The preparation of these payee statements given to taxpayers is integrally connected with the preparation of the parallel information returns given to the IRS. The federal conference committee believed that this initial 30-day period would give filers of these information returns an appropriate amount of time within which to correct failures with respect to documents prepared for the IRS without jeopardizing the provision of the payee statements directly to taxpayers on a timely basis.

Similarly, the federal conference committee chose the August 1 date because this is approximately the date on which the IRS begins intensive processing and use of this data. Consequently, submission of the data after this date is effectively equivalent to not providing the data at all. The federal conference committee expected that in future years advancements in available technology may permit the IRS to utilize this data earlier in the year. If this proves to be the case, the federal conference committee expects the IRS to request that the Congress consider modifying this deadline legislatively.

The new federal law also provided a special rule for de minimis failures to include the required, correct information. This exception applies to incorrect information returns that are corrected on or before August 1. Under the exception, if an information return is originally filed without all of the required information or with incorrect information and the return is corrected on or before August 1, then the original return is treated as having been filed with all of the correct required information. The number of information returns that may qualify for this exception for any calendar year is limited to the greater of (1) 10 returns or (2) one-half of one percent of the total number of information returns that are required to be filed by the person during the calendar year.

The use of 10 returns for this purpose effectively provides a special small-business rule in this penalty. According to IRS statistics, approximately 84 percent of payors who file information returns with the IRS file 10 or fewer forms. Thus, these payors will have until August 1 to correct without penalty errors of omission or commission on information returns that were originally timely-filed with the IRS. If the total number of returns corrected by the taxpayer exceeds the de minimis threshold, only the number exceeding the threshold is subject to penalty. This specific de minimis rule in no way restricts the ability of the IRS or the courts to grant a waiver based on reasonable cause (discussed below).

In addition, the new federal law provided special, lower maximum levels for this penalty for small businesses. Small businesses are defined as firms having average annual gross receipts for the most recent 3 taxable years that do not exceed $5 million. The maximum penalties for small businesses are: $25,000 (instead of $75,000) if the failures are corrected on or before 30 days after the prescribed filing date; $50,000 (instead of $150,000) if the failures are corrected on or before August 1; and $100,000 (instead of $250,000) if the failures are not corrected on or before August 1.

The federal conference committee intended that taxpayers who correct errors in payor statements filed with IRS also make any necessary parallel corrections to payee statements provided to taxpayers. In addition, the federal conference committee intended that the substance of the current IRS temporary regulations (Treasury. Reg. Sec. 301.6723-1T(b)), providing an exception from penalty for inconsequential omissions and inaccuracies, be continued and expanded to apply to information returns, payee statements, and failures to comply with other information reporting requirements (new Sec. 6721, 6722, and 6723).

In addition, the federal conference committee noted that the IRS permits taxpayers to request extensions of time to file information returns (such as by Form 8809). The federal conference committee approved of the existence of administrative procedures to consider requests for extension and expected that these types of procedures will continue to be available to payors.

The new federal law maintained the present law rules for failures that are due to intentional disregard of the filing requirement. Failure to correct information returns within a reasonable time after being requested to do so by the IRS could be considered to be intentional disregard. In addition, some have expressed to the federal conference committee the belief that the overall caps on these penalties are inappropriate, in that payors who are required to file large number of information returns or payee statements may ignore the requirements to do so and pay the maximum penalty as a "cost of doing business" where it is less than the cost of compliance would be. The federal conference committee believed that the general caps serve an important function and should be retained.

The federal conference committee believed that behavior such as ignoring filing requirements in the manner just described is intentional disregard of those requirements, and that payors who engage in such behavior should be subject to the higher penalties (without caps) that apply in cases of intentional disregard.

REVENUE RECONCILIATION ACT OF 1989

Failure to Furnish Correct Payee Statements (IRC Sec. 6722)

Under the new federal law, any person that fails to furnish a correct payee statement to a taxpayer on or before the prescribed due date is subject to a penalty (as under present law) of $50 per statement, with a maximum penalty of $100,000 per calendar year. If the failure to furnish a correct payee statement to a taxpayer is due to intentional disregard of the requirement, the bill generally provides a penalty of $100 per statement or, if greater, 10 percent of the amount required to be shown on the statement, with no limitation on the maximum penalty per calendar year. The federal conference committee did not alter the present law deadline by which these payee statements must be furnished, because it believed that it is vital to the integrity of the self-assessment system that taxpayers receive their payee statements on a timely basis. Many taxpayers rely on the timely receipt of these payee statements so that these taxpayers can complete their own tax returns on a timely basis.

Failure to Comply with Other Information Reporting Requirements (IRC Sec. 6723)

Under the new federal law, any person that fails to comply with other specified information reporting requirements on or before the prescribed date is subject to a penalty of $50 for each failure, with a maximum penalty of $100,000 per calendar year. The information reporting requirements specified for this purpose include any requirement to include a correct taxpayer identification number on a return or statement and any requirement to furnish a correct taxpayer identification number to another person. The new federal law coordinates this penalty with the penalty for failure to file correct information returns and the penalty for failure to file correct payee statements by making this penalty inapplicable to failures penalized under those provisions.

Waiver, Definitions, and Special Rules (IRC Sec. 6724)

The bill consolidates the waiver standards relating to information reporting into one provision. The new federal law provides that any of the information reporting penalties may be waived if it is shown that the failure to comply is due to reasonable cause and not to willful neglect. The federal conference committee intended that for this purpose, reasonable cause exists if significant mitigating factors are present, such as the fact that a person has an established history of complying with the information reporting requirements. The separate, higher waiver standard under present law for interest and dividends is repealed. Interest and dividend returns and statements are consequently subject to this general waiver standard. The federal conference committee intends that payors of interest and dividends that comply with the present law due diligence standards be considered (for purposes of this bill) to have established reasonable cause.

Failure to Provide Place of Residence (IRC Sec. 6017A, 6687)

The federal conference bill repealed these provisions.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The information reporting provisions of the bill generally apply to information returns and payee statements the due date for which (determined without regard to extensions) is after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: MODIFIES UNIFORM REQUIREMENTS FOR RETURNS ON MAGNETIC MEDIA

ACT SECTION: 7713

PRIOR FEDERAL LAW (IRC Sec. 6011)

Present law requires persons filing more than 50 information returns relating to payments of interest, dividends, and patronage dividends to file all such returns on magnetic media. In addition, under federal regulations, persons filing more than 250 information returns (other than interest, dividends, or patronage dividends) are required to file those returns on magnetic media.

CURRENT CALIFORNIA LAW (Sec. 19272)

California law follows federal law and specifies that it applies only when the payor is required to file on magnetic media under the provisions of IRC Sec. 6011(e).

NEW FEDERAL LAW (IRC Sec. 6011)

The new federal law provided that uniform magnetic media requirements apply to all information returns filed during any calendar year. The new federal law accomplished that by making statutory the requirement currently contained in IRS regulations that persons filing more than 250 information returns file those returns on magnetic media. The new federal law made this requirement applicable to all types of information returns.

The federal conference committee intended that the IRS permit payors to file in as many formats as is feasible, and that IRS requirements keep pace with technological advances.

The new federal law provided that the penalty for failing to file information returns on magnetic media when required to do so applies only to the number required to be so filed that exceeds 250. The penalties for failure to file on a timely basis correct information returns would apply to the first 250 returns.

The new federal law provides that the IRS is to take into account (among other factors) the ability of the taxpayer to comply at a reasonable cost with the magnetic media filing requirements. The federal conference committee intended that the IRS take into consideration other instances of undue hardship, such as temporary equipment breakdowns or destruction of magnetic media equipment, in granting one-year or multi-year exemptions from this requirement.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The information reporting provisions of the bill generally apply to information returns and payee statements the due date for which (determined without regard to extensions) is after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: REVISION OF ACCURACY RELATED PENALTIES

ACT SECTION: 7721

PRIOR FEDERAL LAW

Negligence Penalty (IRC Sec. 6653(a))

If any part of an underpayment of tax required to be shown on a return is due to negligence or disregard of rules or regulations, a penalty may be imposed equal to 5 percent of the total amount of the underpayment. An underpayment of tax that is attributable to a failure to include on an income tax return an amount shown on an information return is treated as subject to the negligence penalty absent clear and convincing evidence to the contrary.

Fraud Penalty (IRC Sec. 6653(b))

If any part of an underpayment of tax required to be shown on a return is due to fraud, a penalty may be imposed equal to 75 percent of the portion of the underpayment that is attributable to fraud.

Substantial Understatement Penalty (IRC Sec. 6661)

If the correct income tax liability of a taxpayer for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations), then a substantial understatement exists and a penalty may be imposed equal to 25 percent of the underpayment of tax attributable to the understatement. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return. Special rules apply to tax shelters.

Valuation Penalties (IRC Sec. 6659, 6659A, and 6660)

If an individual, personal service corporation, or closely held corporation underpays income tax for any taxable year by $1,000 or more as a result of a valuation overstatement, then a penalty may be imposed with respect to the amount of the underpayment that is attributable to the valuation overstatement. A valuation overstatement exists if the valuation or adjusted basis of any property claimed on a return is 150 percent or more of the correct value or adjusted basis. The amount of the penalty that may be imposed increases from 10 to 20 to 30 percent of the underpayment attributable to the valuation overstatement as the percentage by which the valuation claimed exceeds the correct valuation increases. Similar penalties may be imposed with respect to (1) an underpayment of income tax that is attributable to an overstatement of pension liabilities and (2) an underpayment of estate or gift tax that is attributable to a valuation understatement.

REASON FOR CHANGE

The federal conference committee believed that the number of different penalties that relate to accuracy of a tax return, as well as the potential for overlapping among many of these penalties, causes confusion among taxpayers and leads to difficulties in administering these penalties by the IRS. Consequently, the federal conference committee has revised these penalties and consolidated them. The federal conference committee believed that its changes will significantly improve the fairness, comprehensibility, and administration of these penalties.

CURRENT CALIFORNIA LAW

Negligence (Sec. 18684, 18698.5, 25934)

California law follows federal law, except that no penalty is assessed to an estate or trust where the amount of unreported income is less than $100.

Fraud (Sec. 18684 and 25934)

California law follows federal law.

Substantial Understatement (Sec. 18684.4, 25934.4)

Under the Personal Income Tax Law, California law is conformed to federal law by reference.

Under the Banks and Corporation Tax Law, California is also conformed to federal law by reference, except that the penalty applies only to tax shelters. The Bank and Corporation penalty was limited in response to the concerns of corporate taxpayers that the Franchise Tax Board might apply the penalty to audit adjustments of corporations engaged in a unitary business.

Valuation (Sec. 18699)

California law follows federal law with respect to valuation overstatements of income tax (IRC Sec. 6659).

California law does not contain any provisions similar to IRC Sec. 6659A, Addition to Tax in Case of Overstatements of Pension Liabilities, or IRC Sec. 6660, Addition to Tax in the Case of Valuation Understatement for purposes of estate or gift taxes.

REVENUE RECONCILIATION ACT OF 1989

NEW FEDERAL LAW

Overview

The new federal law consolidated into one part of the Internal Revenue Code all of the generally applicable penalties relating to the accuracy of tax returns. The penalties that were consolidated are the negligence penalty, the substantial understatement penalty, and the valuation penalties. These consolidated penalties are also coordinated with the fraud penalty. The new federal law repealed the present law versions of these penalties. The new federal law reorganized the accuracy penalties into a new structure that operates to eliminate any stacking of the penalties.

Accuracy-Related Penalty (IRC Sec. 6662)

The accuracy-related penalty, which is imposed at a rate of 20 percent, applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation overstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement.

<u>Negligence</u> If an underpayment of tax is attributable to negligence, the negligence penalty is to apply only to the portion of the underpayment that is attributable to negligence rather than, as under present law, to the entire underpayment of tax. This is a significant change from present law. Under present law, if any portion of an underpayment is attributable to negligence, the negligence penalty applies to the entire underpayment (both the portion attributable to negligence and the portion not attributable to negligence). Thus, under present law, a taxpayer who has an underpayment, only a small portion of which was attributable to negligence, is subject to the same penalty as a taxpayer with the same underpayment, all of which is attributable to negligence, even though the behavior of the first taxpayer is arguably less culpable than the behavior of the second taxpayer. The bill rectifies this inequity by applying the negligence penalty only to the portion of the underpayment attributable to negligence.

Negligence includes any careless, reckless, or intentional disregard of rules or regulations, as well as any failure to make a reasonable attempt to comply with the provisions of the Code. In addition, the bill repeals the present law presumption under which an underpayment is treated as attributable to negligence if the underpayment is due to a failure to include on an income tax return an amount shown on an information return. As a practical matter, even in the absence of a statutory presumption, evidence of such a failure is still strong evidence of negligence.

Substantial Understatement of Income Tax The accuracy-related penalty that applies to the portion of an underpayment that is attributable to a substantial understatement of income tax is the same as the substantial understatement penalty provided under present law with three principal modifications.

First, the rate is lowered to 20 percent.

Second, the federal conference committee expands the list of authorities upon which taxpayers may rely (currently contained in Treasury regulations) to include proposed regulations, private letter rulings, technical advice memoranda, actions on decisions, general counsel memoranda, information or press releases, notices, and any other similar documents published by the IRS in the Internal Revenue Bulletin. In addition, the list of authorities is to include General Explanations of tax legislation prepared by the Joint Committee on Taxation (the "Blue book").

Third, the bill requires the IRS to publish not less frequently than annually a list of positions for which the IRS believes there is no substantial authority and which affect a significant number of taxpayers. The purpose of this list is to assist taxpayers in determining whether a position should be disclosed in order to avoid the substantial understatement penalty. Thus, if a taxpayer takes a position that is enumerated on this list, the taxpayer could choose to disclose that position to avoid imposition of the substantial understatement component of the accuracy-related penalty. However, inclusion of a position on this list is not conclusive as to whether or not substantial authority exists with respect to that position. If, however, there is litigation as to whether there is substantial authority, and the court concludes that the IRS is correct in the belief that there is not substantial authority for the position, then this penalty would apply. The federal conference committee believed that this list will be useful to taxpayers, in that it will assist taxpayers in determining whether substantial authority exists with respect to a particular issue on the list. Although the list is not exclusive, the federal conference committee intends that the IRS make the list as comprehensive as practical, which will make it more useful to taxpayers and their advisors.

The federal conference committee intends that there should be no inference that substantial authority exists with respect to positions that are not included on this list. Disclosure of a position for purposes of this penalty does not necessarily prevent imposition of the negligence penalty. Thus, for example, if a taxpayer discloses a frivolous position, the imposition of the negligence penalty could be appropriate.

Substantial Valuation Overstatement The penalty that is to apply to the portion of an underpayment that is attributable to a substantial valuation overstatement is generally the same as the valuation overstatement penalty provided under present law with five principal modifications.

First, the bill extends the penalty to all taxpayers. The federal conference committee believed that this modification increases the fairness of this component of the accuracy-related penalty, in that the penalty is imposed upon proscribed behavior, regardless of who engages in it.

Second, a substantial valuation overstatement exists if the value or adjusted basis of any property claimed on a return is 200 percent or more of the correct value or adjusted basis.

Third, the penalty is to apply only if the amount of the underpayment attributable to a valuation overstatement exceeds $5,000 ($10,000 in the case of most corporations). This increases five-fold the threshold below which the penalty does not apply to individuals.

Fourth, the amount of the penalty for a substantial valuation overstatement is 20 percent of the amount of the underpayment if the value or adjusted basis claimed is 200 percent or more but less than 400 percent of the correct value or adjusted basis.

Fifth, as explained below, the bill provides that the rate of this penalty is doubled if the value or adjusted basis claimed is 400 percent or more of the correct value or adjusted basis. The bill retains the special rules in present law that apply to charitable deduction property.

The federal conference committee believed that raising both the threshold and the minimum percentage will eliminate from the penalty's scope a number of instances of good-faith valuation disputes that may be subject to penalty under present law. As under present law, valuation misstatements that do not fall within the scope of this or the following elements of the accuracy-related penalty may still be subject to penalty if they are attributable to negligence or fraud or give rise to a substantial understatement of income tax.

Substantial Overstatement of Pension Liabilities The accuracy-related penalty also applies to substantial overstatements of pension liabilities. This penalty is derived from the present law penalty in section 6659A. The federal conference committee has, however, modified the present law penalty by providing that the taxpayer is subject to this component of the accuracy-related penalty only if the actuarial determination of pension liabilities (taken into account for purposes of computing the deduction under paragraph (1) or (2) of section 404(a)) is 200 percent or more of the amount determined to be correct (under present law, the penalty applies to claims 150 percent or more in excess of the amount determined to be correct). As under present law, this penalty applies only if the underpayment attributable to the valuation overstatement exceeds $1,000.

<u>Substantial Estate or Gift Tax Valuation Understatement</u> The accuracy-related penalty also applies to substantial estate or gift tax valuation understatements. This penalty is derived from the present law penalty in section 6660. The federal conference committee has, however, modified the present law penalty by providing that the taxpayer is subject to this penalty only if the value of any property claimed on an estate or gift tax return is 50 percent or less of the amount determined to be correct. (Under present law, the penalty applies to claims that are 66-2/3 percent or less of the amount determined to be correct.) In addition, the federal conference committee has modified the present law penalty by increasing five-fold the threshold below which the penalty does not apply, from $1,000 to $5,000. The federal conference committee believed that raising both the threshold and the minimum percentage will eliminate from the penalty's scope a number of instances of good-faith valuation disputes that may be subject to penalty under present law.

<u>Gross Valuation Misstatements</u> The new federal law provided that the rate of the general accuracy penalty is to be doubled (to 40 percent) in the case of gross valuation misstatements. There are three types of gross valuation misstatements. The first is the same as the substantial valuation overstatement component of the accuracy-related penalty, except that the doubling is to apply only to valuation overstatements claimed on a return that are 400 percent or more of the amount determined to be the correct amount. The second is the same as the substantial overstatement of pension liabilities component of the accuracy-related penalty, except that the doubling is to apply only to overstatements of pension liabilities that are 400 percent or more of the amount determined to be the correct amount. The third is the same as the substantial estate or gift tax valuation understatement component of the accuracy-related penalty, except that the doubling is to apply only to valuations claimed on the estate or gift tax return that are 25 percent or less of the amount determined to be the correct amount.

Fraud Penalty (IRCSec. 6663)

The fraud penalty, which is imposed at a rate of 75 percent, applies to the portion of any underpayment that is attributable to fraud. The federal conference committee has retained the special rule in present law that determines the portion of the understatement that is attributable to fraud. The bill provides that, if the IRS establishes that any portion of an underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, except with respect to any item that the taxpayer establishes is not attributable to fraud. The federal conference committee has clarified the taxpayer's burden of proof in establishing the items not attributable to fraud (present law is unclear on this issue). The federal conference committee has provided that the taxpayer must establish the items not attributable to fraud by a preponderance of the evidence. The federal conference committee has not altered the present law burden of proof imposed on the IRS in establishing fraud initially; the IRS must continue to meet its burden of proof by clear and convincing evidence. The federal conference committee believed that it is appropriate that the burden imposed on the IRS be higher than the burden imposed on a taxpayer in these circumstances.

Under the new federal law, the accuracy-related penalty is not to apply to any portion of an underpayment on which the fraud penalty is imposed. (Under present law, the fraud penalty is coordinated in this manner with the negligence penalty, but not with the other components of the accuracy-related penalty.) However, the accuracy-related penalty may be applied to any portion of the underpayment that is not attributable to fraud.

Definitions and Special Rules (IRC Sec. 6664)

The bill provides special rules that apply to each of the penalties imposed under the new structure. First, the bill provides standardized exception criteria for all of these accuracy-related penalties. The bill provides that no penalty is to be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith. The enactment of this standardized exception criterion is designed to permit the courts to review the assertion of penalties under the same standards that apply in reviewing additional tax that the Internal Revenue Service asserts is due. By applying this unified exception criterion to all the accuracy-related penalties, the federal conference committee believed that taxpayers will more easily understand the standard of behavior that is required. The federal conference committee also believes that this unified exception criterion will simplify the administration of these penalties by the IRS.

The federal conference committee is concerned that the present law accuracy-related penalties (particularly the penalty for substantial understatements of tax liability) have been determined too routinely and automatically by the IRS. The federal conference committee expects that enactment of standardized exception criterion will lead the IRS to consider fully whether imposition of these penalties is appropriate before determining these penalties.

In addition, the federal conference committee has designed this standardized exception criterion to provide greater scope for judicial review of IRS determinations of these penalties. Under the waiver provision contained in present law, the Tax Court has held that it can overturn an IRS determination of the substantial understatement penalty on reasonable cause and good faith grounds only if the Tax Court finds that the IRS abused its discretion in asserting the penalty. The federal conference committee believed that it is appropriate for the courts to review the determination of the accuracy-related penalties by the same general standard applicable to their review of the additional taxes that the IRS determines are owed. The federal conference committee believed that providing greater scope for judicial review of IRS determinations of these penalties will lead to greater fairness of the penalty structure and minimize inappropriate determinations of these penalties.

The federal conference committee believed that the application of standardized exception criteria to the negligence component of the accuracy-related penalty will result in several consequences that are beneficial to taxpayers.

First, the complete, item-specific disclosure of a nonfrivolous position on a tax return may generally be considered to permit an exception from the negligence penalty insofar as such disclosure would tend to demonstrate that there was no intentional disregard of rules or regulations. Disclosure must be full and substantive, parallel to the disclosure required under the substantial understatement component of the accuracy-related penalty; completing and filling in a tax form is by itself insufficient disclosure for this purpose. In addition, the disclosure must be clearly identified as being made to avoid the imposition of the accuracy-related penalty. Imposition of the negligence component of the accuracy-related penalty would not be eligible for exception due to disclosure where the taxpayer fails to keep proper books and records or to substantiate items properly.

Second, the application of standardized exception criteria to the negligence component of the accuracy-related penalty may also permit a taxpayer to avoid imposition of that penalty where the taxpayer makes a good-faith challenge to the validity of an IRS regulation, if the taxpayer discloses (in the manner just described) that the taxpayer is taking the position and makes specific reference to the regulation being challenged. As under present law, frivolous challenges to IRS regulations would be subject to penalty. The federal conference committee intends that the terms "reasonable cause" and "good faith" be interpreted under the bill as those terms are interpreted under present law.

The new federal law provided that an accuracy-related or fraud penalty is to be imposed only if a return has been filed. This is intended to improve the coordination between the accuracy-related penalties and the failure to file penalties. Under present law, the courts have dealt with a number of difficult interpretative issues on the relationship between the penalty for failure to file a tax return and the accuracy-related penalties. The federal conference committee determined that it would clarify the law if the penalty for failure to file were entirely separate and distinct from the accuracy-related penalties. (The bill also provides for an increase in the failure to file penalty where that failure is due to fraudulent failure to file.)

Third, the new federal law provided a standard definition of underpayment for all of the accuracy-related penalties. This standard definition is intended to simplify and coordinate the definitions in present law; it is not intended to be substantively different from present law.

The new federal law retained the general rule of present law that interest on these penalties commences with the date the return was required to be filed. The federal conference committee believed this rule is appropriate because the behavior being penalized is reflected on the tax return, so that imposition of interest from this date will reduce the incentives of taxpayers and their advisors to "play the audit lottery."

<u>Repeal of Present-Law Penalties</u>

The new federal law repealed the following present law penalties:

Negligence (Sec. 6653(a))

Fraud (Sec. 6653(b))

Substantial Understatement of Liability (Sec. 6661)

Valuation Overstatements (Sec. 6659 and 6659A)

Valuation Understatements for Purposes of Estate or Gift Taxes (Sec. 6660)

Special Negligence Rules Applicable to Straddles (Sec. 6653(f))

Special Negligence Rules Applicable to Amounts Shown on Information Returns (Sec. 6653(g))

The federal conference committee believed that, by repealing the special rule applicable to information returns, the burdens on taxpayers will be reduced.

Finally, the new federal law repealed the higher interest rate that applied to substantial underpayments that were attributable to tax-motivated transactions (IRC Sec. 6621(c)).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The accuracy provisions of the new federal law generally apply to returns having a due date (determined without regard to extensions) after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: REVISION OF PENALTY FOR INSTITUTING TAX COURT PROCEEDINGS PRIMARILY FOR DELAY

ACT SECTION: 7731

PRIOR FEDERAL LAW (IRC Sec. 6673)

Whenever it appears to the Tax Court that the taxpayer's position is frivolous or groundless, the Tax Court may assess a fine of up to $5,000 which is to be assessed and collected in the same manner as a tax.

In the case of a taxpayer who asserts entitlement to civil damages for unauthorized collection actions (IRC Sec. 7433) with a frivolous or groundless position, the Tax Court may assess a fine of up to $10,000.

CURRENT CALIFORNIA LAW (Sec. 19414)

California law follows federal law with respect to frivolous or groundless positions taken before the California Board of Equalization or the state courts.

California law does not have a special rule relating to assertion of civil damages for unauthorized collection action, since California law has no counterpart to IRC Sec. 7433. The federal provision was enacted as a part of the Technical and Miscellaneous Revenue Act of 1988.

NEW FEDERAL LAW (IRC Sec. 6673)

The bill authorizes the Tax Court to impose a penalty not to exceed $25,000 if a taxpayer (1) institutes or maintains a proceeding primarily for delay, (2) takes a position that is frivolous, or (3) unreasonably fails to pursue available administrative remedies. The federal conference committee intends that the increased penalty (above $5,000) apply primarily (but not exclusively) to tax shelter cases, where the $5,000 maximum provided under present law appears to be ineffective in deterring taxpayers from taking frivolous positions.

The federal conference committee explicitly chose to call these awards "penalties", rather than "damages" (as under present law), so that it is clear that specific damages incurred by the United States need not be proved before the court may impose this penalty. The federal conference committee believed that dealing with these frivolous lawsuits wastes scarce judicial resources and delays the resolution of legitimate disputes. The federal conference committee expects that its modifications to this provision will further decrease frivolous lawsuits. The federal conference committee also intends to monitor the use of this penalty to ensure that it continues to be used, as it has in the past, only in situations in which its use is appropriate. The federal conference committee has also called these awards "penalties" rather than "damages" in the parallel provisions applicable to other courts. The federal conference committee has provided that any monetary sanctions, penalties, or costs awarded in a tax case by one of these other courts may be assessed and collected in the same manner as a tax. This permits these sanctions, penalties, and costs, when awarded by one of these other courts, to be collected in the same manner as if they were awarded by the Tax Court.

The federal conference committee eliminated the last sentence from present law Section 6673(a) (relating to assessment and payment) because, in light of the use of the term "penalty", the purpose of that last sentence is accomplished by Section 6671(a). The federal conference committee intends that no substantive modification be made to the assessment and payment procedures because of the deletion of this last sentence of Section 6673(a).

The new federal law also authorized the Tax Court to require any attorney or other person permitted to practice before the Court to pay excess costs, expenses, and attorney's fees that are incurred because the attorney or other person unreasonably and vexatiously multiplied any proceeding before the Court. If the attorney is appearing on behalf of the Commissioner of Internal Revenue, the United States is to pay these costs in the same manner as an award of these costs by a district court. This provision is comparable to the authority already provided to district courts under 28 U.S.C. Section 1927.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The new federal law is applicable to positions taken after December 31, 1989, in proceedings which were pending on or commenced after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: MODIFICATION TO PENALTIES ON RETURN PREPARERS

ACT SECTION: 7732-7733

PRIOR FEDERAL LAW (IRC Sec. 6694, 6695)

An income tax return preparer is subject to a penalty of $100 if any part of an understatement of tax on a return or claim for refund is due to the return preparer's negligent or intentional disregard of rules and regulations. In addition, an income tax return preparer is subject to a penalty of $500 if any part of an understatement of tax on a return or claim for refund is due to the return preparer's willful attempt in any manner to understate tax.

An income tax return preparer is also subject to a penalty of $25 for each failure to (1) furnish a copy of a return or claim for refund to the taxpayer; (2) sign the return or claim for refund; or (3) furnish his or her identifying number.

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (Sec. 18684.6, 18684.7, 25934.6)

Understatement of Tax on Return or Claim For Refund

California law (Sec. 18684.6, 25934.6) follows federal law (IRC Sec. 6694), including the amounts of the penalties.

Failure to Furnish a Copy of a Return or Claim For Refund

California law (Sec. 18684.7) follows federal law (IRC Sec. 6695) with respect to the requirements under IRC Sec. 6107(a) or RTC Sec. 18935.

Failure to Furnish an Identification Number

California law (Sec. 18684.7) follows federal law (IRC Sec. 6695) with respect to the requirements under IRC Sec. 6107(b) or RTC Sec. 18935.

Failure to Sign a Return or Claim For Refund

California law does not contain any provision similar to IRC Sec. 6695(b).

Failure to File Correct Information

California law does not contain any provision similar to IRC Sec. 6060.

Penalty for Negotiation of Check Issued to Taxpayer

California law does not contain any provision similar to IRC Sec. 6695(f).

NEW FEDERAL LAW (IRC Sec. 6694, 6695)

The new federal law revises the present law penalties that apply in the case of an understatement of tax that is caused by an income tax return preparer. First, the bill provides that if any part of an understatement of tax on a return or claim for refund is attributable to a position for which there was not a realistic possibility of being sustained on its merits and if any person who is an income tax return preparer with respect to such return or claim for refund knew (or reasonably should have known) of such position and such position was not disclosed or was frivolous, then that return preparer is subject to a penalty of $250. The penalty is not imposed if there is reasonable cause for the understatement and the return preparer acted in good faith. The federal conference committee has adopted this new standard because it generally reflects the professional conduct standards applicable to lawyers and to certified public accountants. The federal conference committee believed that this standard of behavior is stricter than present law, so that negligent behavior subject to penalty under present law will continue to be subject to penalty under this new standard.

The federal conference committee intended that imposition of this penalty not lead to an automatic referral to the Internal Revenue Service Director of Practice. The federal conference committee believed that the IRS should exercise discretion in referring the specific cases to the Director of Practice. The federal conference committee also intended that, in exercising this discretion in response to this provision, the IRS would not generally expand its investigations of preparer penalty cases.

In addition, the new federal law provides that if any part of an understatement of tax on a return or claim for refund is attributable to a willful attempt by an income tax return preparer to understate the tax liability of another person or to any reckless or intentional disregard of rules or regulations by an income tax return preparer, then the income tax return preparer is subject to a penalty of $1,000. The federal conference committee intended that rules parallel to those discussed above, which provide that specified disclosure tends to demonstrate that there was no intentional disregard of rules and regulations for purposes of the negligence penalty, also apply to this penalty.

REVENUE RECONCILIATION ACT OF 1989

The return preparer penalties that apply to each failure to (1) furnish a copy of a return or claim for refund to the taxpayer, (2) sign the return or claim for refund, (3) furnish his or her identifying number, and (4) file a correct information return, are made uniform. The penalty is $50 for each failure and the total penalties imposed for any single type of failure for any calendar year are limited to $25,000.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modifications to the return preparer penalties apply to documents prepared after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: MODIFIED PENALTY FOR PROMOTING ABUSIVE TAX SHELTERS

ACT SECTION: 7734

PRIOR FEDERAL LAW (IRC Sec. 6700)

Any person who organizes, assists in the organization of, or participates in the sale of any interest in, a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, is subject to a penalty if in connection with such activity the person makes or furnishes a false or fraudulent statement or a gross valuation overstatement. The amount of the penalty equals the greater of $1,000 or 20 percent of the gross income derived or to be derived by the person from the activity. It is unclear under present law whether the term "activity" refers to each sale of an interest in a tax shelter or whether it refers to the overall activity of promoting an abusive tax shelter.

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (Sec. 19415, 25957)

California law is conformed by reference to federal law, including penalty amounts.

NEW FEDERAL LAW (IRC Sec. 6700)

Under the new federal law, the amount of the penalty imposed for promoting abusive tax shelters equals $1,000 (or, if the person establishes that it is less, 100 percent of the gross income derived or to be derived by the person from such activity). In calculating the amount of the penalty, the organizing of an entity, plan or arrangement and the sale of each interest in an entity, plan, or arrangement constitute separate activities. The federal conference committee has made these modifications because the courts have differed in their interpretations of the provisions of present law. The federal conference committee believed that its modifications would eliminate confusion for cases arising in the future. The bill also clarifies that the penalty applies to direct or indirect actions.

REVENUE RECONCILIATION ACT OF 1989

The federal conference committee was concerned about the large number of old tax shelter cases that await resolution. The federal conference committee recognized that the Tax Court has, in the last several years, made significant progress in reducing its inventory of old tax shelter cases. The federal conference committee expects the Tax Court as well as the IRS to redouble their efforts to resolve or encourage settlement of old tax shelter cases. The federal conference committee realizes that delay is often caused by the litigants themselves. The federal conference committee encourages the Tax Court to use every means within its disposal, including the sanctions on litigants and attorneys imposed under this bill, to encourage litigants to resolve their disputes as expeditiously as possible. Similarly, the federal conference committee encourages the IRS to make every effort to resolve old tax shelter cases, through means such as additional settlement initiatives, better caseload management, and better utilization of the appeals process.

The federal conference committee wished to clarify that, under present law, "investment plan or arrangement" and "other plan or arrangement," as those terms are used in Section 6700 of the Code, include obligations issued by or on behalf of State or local governments which are represented to be described in Section 103(a) of the Code ("bonds"). Therefore, the penalty imposed by Section 6700 may apply to bond counsel, investment bankers and their counsel, issuers (and beneficiaries of "conduit" bonds) and their counsel, financial advisors, feasibility consultants and engineers, and other persons, who (1) are involved in the organization or sale of such State or local government bonds and (2) know or have reason to know that their opinions, offering documents, reports, or other statements (or material on which they relied in making such statements) are false or fraudulent as to any matter material to the tax exemption of the interest on the bonds. A person who makes a statement facilitating the issuance or sale of State or local government bonds (including a sale occurring subsequent to the issuance of the bonds) is involved in the organization or sale of such bonds.

Whether a person who makes or furnishes or causes another person to make or furnish a statement in connection with the organization or sale of bonds (including a statement that interest on the bonds is exempt from taxation), knows or has reason to know that such person's statement is false or fraudulent as to any material matter depends upon that person's role in the organization or sale. For example, bond counsel, issuer's counsel, and underwriter's counsel would be entitled to reply upon a feasibility study conducted by an engineering firm reputed to be expert in the subject matter and area of the study, unless such counsel independently knew or had reason to know information bringing into question the results of that study.

Absent that, counsel would not be required to question the assumptions underlying, or results reached by, the study. Similarly, bond counsel would be able to rely, as to matters of fact or expectation relevant to his or her opinion, on information provided by other parties (including the issuer) absent actual knowledge or a reason to know of its inaccuracy or the use of statements not credible or reasonable on their face. On the other hand, bond counsel must draw their own legal conclusions from that information. For example, bond counsel may rely on an engineer's description of a facility as to its physical characteristics, operations, functions, and performance, but would not be able to rely on such certification for counsel's legal conclusion that the facility qualified under Section 142 of the Code. Similarly, an investment banking firm organizing or assisting in the organization of the bonds holding itself out as expert in the particular subject area of the financing would have reason to question the conclusion of a feasibility consultant if that consultant's report omitted consideration of a principal factor typically discussed in feasibility reports used in such financings (e.g., competition for a project's source of supply of materials).

In addition, Section 6700 applies even if the Service has insulated bondholders from the effect of a declaration of taxability of a bond sold as tax-exempt by entering into a closing agreement with the issuer of the bonds. Furthermore, so long as there has been a determination that a false or fraudulent statement (which may include a conclusion of law based on a false or fraudulent statement) has been utilized, action under Section 6700 is not precluded by failure of the Service to enter into a closing agreement, to declare taxability, or otherwise to penalize the issuer or owners of the bonds in question. In addition, action may be taken under Section 6700 prior to delivery of bonds if a false or fraudulent statement is being used in their offering.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modifications to the penalty for promoting abusive tax shelters and the aiding and abetting penalty apply to activities after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: MODIFIES PENALTY FOR AIDING AND ABETTING UNDERSTATEMENT OF TAX LIABILITY

ACT SECTION: 7735

PRIOR FEDERAL LAW (IRC Sec. 6701)

Any person who aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document under the tax laws which (1) the person knows will be used in connection with any material matter arising under the tax laws, and (2) the person knows will (if so used) result in an understatement of the tax liability of another person is subject to a penalty equal to $1,000 for each return or other document ($10,000 in the case of returns and documents relating to the tax of a corporation).

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (Sec. 19416, 25957.1)

California law is conformed to federal law by reference, including penalty amounts.

NEW FEDERAL LAW (IRC Sec. 6701)

The new federal law amended the penalty for aiding and abetting the understatement of tax liability by imposing the penalty in cases where the person aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document if (1) the person knows or has reason to believe that the return or other document will be used in connection with any material matter arising under the tax laws, and (2) the person knows that if the portion of the return or other document were so used, an understatement of the tax liability of another person would result. In addition, the new federal law provided that a penalty for promoting abusive tax shelters is not to be imposed on any person with respect to any document if an aiding and abetting penalty is imposed on such person with respect to the same document. Both penalties may however be imposed with respect to separate documents, such as, for example, when a promoter furnishes promotional material at the time of sale and subsequently provides partnership schedules

(Forms K-1) to the investors. The federal conference committee believed that this penalty should not be used as a means of avoiding the procedural requirements of a John Doe summons under Section 7609(f).

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modifications to the penalty for promoting abusive tax shelters and the aiding and abetting penalty apply to activities after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: MODIFIED PENALTY FOR FRIVOLOUS INCOME TAX RETURN

ACT SECTION: 7736

PRIOR FEDERAL LAW (IRC Sec. 6703)

Any individual who files a frivolous income tax return is subject to a penalty of $500.

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (Sec. 19418, 25957.3)

California law follows federal law, but refers to state administrative procedures in lieu of federal procedures.

NEW FEDERAL LAW (IRC Sec. 6703)

The new federal law deleted the special provision in present law permitting taxpayers who contest the imposition of this penalty to pay 15 percent of the penalty, which halts further collection proceedings until final judicial resolution of the dispute. Thus, taxpayers who wish to contest imposition of this penalty must pay the full penalty before seeking judicial review of imposition of the penalty. The federal conference committee believed that repealing this special 15-percent rule places taxpayers who contest this penalty by way of a refund action in the same position as taxpayers who contest the assertion that they owe additional tax to the IRS. By repealing this special rule, the bill makes suits for refund of this penalty permissible only under the generally applicable rules on suits for refunds. Suits contesting the imposition of this penalty may be brought only in the district courts and the Claims Court.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modification to the frivolous income tax return penalty applies to returns filed after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: PROTECTS AUTHORITY TO COUNTERCLAIM FOR BALANCE OF PENALTY IN PARTIAL REFUND SUITS

ACT SECTION: 7737

PRIOR FEDERAL LAW (IRC Sec. 6672, 6694, 6703)

Taxpayers may pay a portion of the penalties for failure to collect and pay over tax, for understatement of a taxpayer's liability by an income tax return preparer, for promoting abusive tax shelters, and for aiding and abetting the understatement of tax liability. By doing so, they may obtain judicial review of the imposition of these penalties. Present law may prohibit the Federal Government from counterclaiming for the balance of the penalty in the same lawsuit.

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (Sec. 18684.6, 19418, 25934.6 and U.I. Code Sec. 2118.5)

California law follows federal law, except that California law does not extend to penalties for failure to collect and pay over tax (IRC Sec. 6672). The state counterpart to IRC Sec. 6672 is U.I. Code Sec. 2118.5 and does not contain provisions relating to judicial review. Also, the state penalty (U.I. Code Sec. 2118.5) is limited to a maximum fine of $2,000 whereas the federal penalty (IRC Sec. 6672) is equal to the amount of tax not collected and paid over.

NEW FEDERAL LAW (IRC Sec. 6672, 6694, 6703)

The new federal law clarified that, where taxpayers utilize the provisions of present law (other than with respect to frivolous income tax returns) that permit partial (rather than full) payment of certain penalties to obtain judicial review of the imposition of these penalties, the United States may counterclaim as part of the same lawsuit for the remainder of the penalty. Present law may prohibit a counterclaim of this nature; thus, an additional lawsuit must be brought even if the taxpayer loses the case brought after partial payment of the tax. The federal conference committee believed that multiple court cases with respect to the same issue wastes scarce judicial resources. Consequently, the federal conference committee permits all issues relating to these penalties to be considered in one lawsuit.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modifications to the court-awarded sanctions apply to proceedings pending on, or commenced after, December 31, 1989. The provision relating to counterclaims is effective on the date of enactment.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: REPEALS BONDING REQUIREMENT FOR TAX RETURN PREPARERS

ACT SECTION: 7738

PRIOR FEDERAL LAW (IRC Sec. 7407)

Return preparers may post a bond, thereby preventing any proceeding by the Federal Government under Section 7407 seeking to enjoin a return preparer from engaging in prohibited conduct.

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (B&P Code Sec. 9831.35)

California law requires a surety bond as a prerequisite for registration under the California Tax Preparers Act. However, the posting of that bond bears no relationship to actions to restrain conduct under B&P Sec. 9891.31.

NEW FEDERAL LAW (None)

The new federal law repealed the provision permitting return preparers to post a bond and thereby prevent any proceeding by the Federal Government under Section 7407 seeking to enjoin a return preparer from engaging in prohibited conduct. The federal conference committee believed that return preparers should not be able to prevent judicial resolution of the issue of whether the return preparer has engaged in prohibited conduct.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision repealing the bonding requirement for return preparers is effective for actions or proceedings commenced after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: MODIFIES PROVISIONS RELATING TO DISCLOSURE OF INFORMATION BY TAX RETURN PREPARERS

ACT SECTION: 7739

PRIOR FEDERAL LAW (IRC Sec. 7216)

In general, return preparers are subject to penalty for disclosing tax return information that is furnished to the return preparer in connection with the preparation of tax returns. The IRS may by regulation provide exceptions to this general prohibition.

REASON FOR CHANGE

The federal conference committee believed that it is appropriate to reconsider, in the context of the entire penalty structure, these specific penalties. These penalties have been enacted and modified on a piecemeal basis, and have not been subject to comprehensive review.

CURRENT CALIFORNIA LAW (None)

NEW FEDERAL LAW (IRC Sec. 7216)

The new federal law provided that the IRS regulations relating to the use of tax information by return preparers are to provide that a return preparer may disclose tax information to another return preparer solely for purposes of quality or peer reviews. The purpose of this provision is to enable a return preparer to obtain the benefits of having another return preparer review the first preparer's work. The bill does not permit disclosure of this information by the IRS for these purposes.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision relating to disclosures by return preparers is effective on the date of enactment.

IMPACT ON CALIFORNIA REVENUE

To be determined.

REVENUE RECONCILIATION ACT OF 1989

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: INCREASED PENALTY FOR FRAUDULENT FAILURE TO FILE

ACT SECTION: 7741

PRIOR FEDERAL LAW (IRC Sec. 6651)

A taxpayer who fails to file a tax return on a timely basis is subject to a penalty equal to 5 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 5 months or 25 percent. The net amount of tax due is the excess of the amount of the tax required to be shown on the return over the amount of any tax paid on or before the due date prescribed for the payment of tax.

CURRENT CALIFORNIA LAW (Sec. 18681, 18684.2, 25931, 25931.3, 25934.2)

California law generally follows federal law, except that California law does not include a higher penalty (1 percent per month) in the case of a tax levy or jeopardy assessment.

NEW FEDERAL LAW (IRC Sec. 6651)

The new federal law modified present law by providing that the fraud and negligence penalties are not to apply in the case of a negligent or fraudulent failure to file a return. Instead, the new federal law provided that in the case of a fraudulent failure to file a return, the failure to file penalty would be increased to 15 percent of the net amount of tax due for each month that the return is not filed, up to a maximum of 5 months or 75 percent. The burden of proof on the fraud element of this increased portion of the penalty is on the IRS (Sec. 7454(a)).

If the IRS does not sustain its burden, and if the IRS determined in the alternative in the notice of deficiency that the taxpayer is liable for the basic failure to file penalty under Section 6651(a)(1), then the Court could consider the basic penalty and the burden of proof in respect thereof would be on the taxpayer. On the other hand, if the IRS does not sustain its burden on the fraud element and failed to make an alternative determination on the notice but did in its answer or other pleading assert that the taxpayer is liable for the basic penalty, then the Court could also consider that penalty but the burden of proof in respect thereof would be on the IRS. Finally, if the IRS does not sustain its burden on the fraud element and failed to either make an alternative determination in the notice or assert the basic penalty in its answer, the Court could not consider that penalty and the taxpayer would not be liable for any failure to file penalty.

REVENUE RECONCILIATION ACT OF 1989

The federal conference committee made this modification to improve the coordination of the failure to file penalty with the accuracy-related penalties. The federal conference committee intended that the courts and the IRS should consider the same elements when considering the imposition of this new aspect of the penalty as is done under present law when considering imposition of the 6653 penalty where there has been a failure to file a return. Thus, the actions or behavior that trigger the penalty under the new federal law are to be the same as those under present law.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modification to the failure to file penalty applies to returns the due date for which (determined without regard to extensions) is after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

TITLE VIIG: REVISION OF CIVIL PENALTIES

ACTION: EFFECT OF PAYMENT OF TAX BY RECIPIENT ON CERTAIN PENALTIES

ACT SECTION: 7743

PRIOR FEDERAL LAW (IRC Sec. 1463)

Persons having control, receipt, custody, disposal, or payment of certain types of U.S. income of foreign persons are required to deduct and withhold U.S. tax from such income under IRC Sec. 1441- 1464. The amount withheld is credited against the U.S. tax liability of the foreign income recipient.

Where a tax on the U.S. income of a foreign recipient was required to be withheld but the withholding agent failed to do so, and instead the tax is paid by the income recipient, a penalty may be imposed on the recipient or the withholding agent for failure to pay the tax only if the failure was fraudulent and for the purpose of evading payment (Sec. 1463). By contrast, where a U.S. employer fails to withhold income tax from an employee's wages but the employee pays the tax due, the employer remains liable for any penalties and additions to tax otherwise applicable (Sec. 3402(d)).

REASON FOR CHANGE

he federal conference committee believed that the flat 10-percent penalty for failure to deposit taxes is very unfair, in that the same penalty applies whether the taxpayer is one day or one year late in making a deposit. The federal conference committee believed that it is important to give taxpayers an incentive to correct as rapidly as possible any failures to deposit.

CURRENT CALIFORNIA LAW

None.

NEW FEDERAL LAW (IRC Sec. 1463)

The new federal law provides that in cases where a tax on the U.S. income of a foreign person was required to be withheld under IRC Sec. 1441-1464 but was not in fact withheld, and the person who would have been entitled to a credit for any withholding tax paid instead satisfies its own proper tax liability, the withholding agent remains liable for any penalties and additions to tax otherwise applicable for failure to withhold. Thus, under the bill these withholding agents are subject to the same general approach applicable to U.S. employers who withhold income taxes from employees' wages.

REVENUE RECONCILIATION ACT OF 1989

EFFECTIVE DATE OF FEDERAL PROVISIONS

The modification to the rules on liabilities of withholding agents applies to failures to deduct and withhold taxes after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

To be determined.

TITLE II: REPEAL OF SECTION 89 NONDISCRIMINATION RULES

ACTION: REPEAL SECTION 89 AND REINSTATE PREVIOUS NONDISCRIMINATION RULES

ACT SECTION: 202 - 204

BACKGROUND

While most employee compensation is taxable income to the employee, employer-provided health coverage generally is excludable from the gross income of the employee receiving the coverage.

In enacting the Tax Reform Act of 1986, the Congress determined that the substantial revenue cost related to employer-provided health insurance coverage is justified only if the tax benefits fulfill important public policy objectives.

Increasing health coverage among rank-and-file employees who otherwise would not purchase ore could not afford such coverage was identified as a primary policy objective underlying the exclusion for employer-provided health care coverage. Conversely, the Congress believed that the cost of tax-favored employer-provided accident and health coverage is not justified if such coverage disproportionately benefits highly compensated employees.

In order to achieve this objective, nondiscrimination rules were enacted (Sec. 89 of the Internal Revenue Code) to permit the full exclusion from income of employer-provided health benefits only if the benefits are provided to required numbers of non-highly compensated employees and the level of benefits provided to highly compensated employees (on average) does not disproportionately exceed the average benefits provided to rank-and-file employees.

PRIOR FEDERAL LAW (IRC Sec. 89)

Under present law, Section 89 imposes nondiscrimination rules on group-term life insurance plans and health plans. Section 89 also imposed minimum qualifications standards on certain types of employee benefit plans. Prior to the enactment of Section 89 as part of the Tax Reform Act of 1986, other nondiscrimination rules applied to group-term life insurance plans, cafeteria plans, and self-insured health plans.

Dependent Care Assistance Programs :

Under present law, gross income does not include benefits received under an employer-provided dependent care assistance program. Dependent care assistance programs are subject to certain nondiscrimination rules, including a benefits test. If these rules are not satisfied then all employees must include in income the benefits received under the program.

Line of Business Rules:

Under present law, if an employer has separate lines of business or maintains separate operating units, each separate line of business or operating unit may be tested separately under the nondiscrimination rules applicable to qualified plans by taking into account only those employees in that line of business or operating unit.

REASON FOR CHANGE

The legislative history indicates that Congress believes that nondiscrimination in the provision of employer-provided health coverage remains an important policy objective. However, the rules enacted in Section 89 are overly complex and unduly burdensome on employers and therefore it is appropriate to repeal them and reinstate the rules applicable before the enactment of Section 89.

CURRENT CALIFORNIA LAW (Sec. 17081, 17092, 17095, 17131, 17501)

California is normally conformed to all the federal nondiscrimination rules for employee benefit plans. However, due to the uncertainty of whether Congress would repeal the Section 89 rules before they became operative, California enacted Section 17095 in AB 802 (KLEHS) which specified that the provisions of Section 89 of the Internal Revenue Code will not apply to taxable years beginning in 1989 and before January 1, 1990.

NEW FEDERAL LAW (IRC Sec. 79, 89, 105, 117, 120, 125, 127, 129, 132,162, 401, 505)

The Act repeals Section 89 of the Internal Revenue Code and generally reinstates the rules applicable before the enactment of Section 89.

Generally, prior law contained nondiscrimination rules relating to group-term life insurance (Sec. 79), employer-provided self-insured medical reimbursement plans (Sec. 105), and cafeteria plans (Sec. 125). These prior law rules are generally reinstated under the Act. Since some employers may have adjusted their plans to comply with the health benefit nondiscrimination rules under Section 89, the committee report indicates that, if the plan would have met the Section 89 rules for 1989, then that plan will be treated as complying with the health benefit nondiscrimination rules reinstated under Section 105(h) for the 1989 plan year.

Also, special rules are provided for voluntary employees' beneficiary associations (VEBA) under Section 505 which have group-term life insurance.

Dependent Care Assistance Programs:

Under the Act, the requirements relating to dependent care assistance programs (Sec. 129) are modified. The Act generally reinstates the rules which were applicable to these programs prior to the enactment of the Tax Reform Act of 1986. In addition, the Act retains the 55-percent benefits test.

Under the Act, if a program fails to meet the requirements, only highly compensated employees must include benefits under the program in gross income. In addition, the 55-percent benefits test may be applied on a separate line of business basis. (Sec. 414)

Employees with less than $25,000 in annual compensation may be disregarded for purposes of the 55-percent benefits test if the benefits are provided through a salary reduction arrangement. Also, certain employees who are under 21 years of age or who have not completed 1 year of service or are covered by a collective bargaining agreement may be disregarded for both the 55-percent benefits test and the reasonable classification test.

Separate Lines of Business or Operating Units:

Under the Act, before the Secretary issues guidelines or determination letters, an employer shall be treated as operating separate lines of business if the employer reasonably determines that it meets the requirements of Section 414(r) (other than paragraph (2)(C) thereof). The committee report indicates that Congress intends that when the Secretary issues guidance employers are to be granted a reasonable time to comply with the guidance.

Also, the committee report indicates that Congress intends that both vertically integrated and horizontally integrated business be able to establish separate lines of business under the reasonable good faith standards under certain circumstances.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provision repealing Section 89 and reinstating prior law is effective as if included in the Tax Reform Act of 1986.

The provisions relating to dependent care assistance programs are generally effective for plan years beginning after December 31, 1989. The 55-percent benefits test does not apply to plan years beginning before January 1, 1990.

The line of business provision is effective for plan years beginning after December 31, 1986.

IMPACT ON CALIFORNIA REVENUE

California has followed federal changes in this area of tax law. In 1989 the State delayed implementation on account of Congressional reexamination of Section 89 rules. Since taxpayers will most likely assume state repeal is imminent, any revenues that may be lost as a result of conformity legislation will be insignificant.

SUPPORT FOR EAST EUROPEAN DEMOCRACY (SEED) ACT OF 1989 (PUBLIC LAW 101-179)

TITLE III: TRADE AND INVESTMENT

ACTION: EXEMPT CERTAIN BONDS ISSUED BY POLAND FROM RULES FOR BELOW-MARKET LOANS

ACT SECTION: 307

PRIOR FEDERAL LAW (IRC Sec. 7872)

In the Tax Reform Act of 1984, Congress enacted a group of rules which recharacterize an interest free or below-market loan as an arms-length transaction in which the lender must treat the foregone interest as income, while the borrower treats the foregone interest as an interest deduction. In determining whether a loan has below-market interest stated in the instrument, the test is made against the rate for federal instruments for the appropriate length instrument (called the Applicable Federal Rate (AFR)). For example, the AFR as of February 1990 is as follows:

Short-Term (maturity of 3 years or less) is 7.98 percent;

Mid-Term (maturity of over 3 years but not over 9 years is 8.06 percent;

Long-Term (maturity of over 9 years) is 8.12 percent.

For term loans, such a bonds, the amount of forgone interest is treated as an amount of original issue discount (OID) upon issuance and the bondholder must include in income the sum of the daily portions of the OID for each day during the tax year they held the bond.

In the Technical Corrections portion of the 1986 Tax Reform Act, Congress provided that rules for below-market loans would not apply to any obligation issued by Israel if the obligation is payable in U.S. dollars and bears interest at an annual rate of not less than four percent.

REASON FOR CHANGE

On November 28, 1989, the President signed the Support for East European Democracy (SEED) Act of 1989. The Act provides that the SEED Program is to be comprised of diverse undertakings designed to provide cost-effective assistance to those countries of Eastern Europe that have taken substantive steps toward institutionalizing political democracy and economic pluralism. One of the twenty five objectives listed is to provide special tax treatment of below-market loans.

SUPPORT FOR EAST EUROPEAN DEMOCRACY (SEED) ACT OF 1989 (PUBLIC LAW 101-179)

CURRENT CALIFORNIA LAW (Sec. 18180, 24990)

California is conformed to federal law prior to this change. In 1987 California conformed to the exclusion of obligations of Israel from the below-market rules in AB 53, Sec. 187 and SB 572, Sec. 231 (Stats. 1987, Ch. 1138 and 1139, respectively).

NEW FEDERAL LAW (Act Sec. 307)

The Act expands the 1986 Tax Reform Act's exemption of certain obligations issued by Israel from the below-market rules (IRC Sec. 7872) to include obligations issued by Poland if the obligation is payable in U.S. dollars and bears interest at an annual rate of not less than four percent.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision applies to obligations issued after November 28, 1989.

IMPACT ON CALIFORNIA REVENUE

Revenue losses would be minor, probably less than $500,000 annually.

TITLE V: OTHER ETHICS REFORMS

ACTION: ALLOWS ROLLOVER OF GAIN ON SALE OF PROPERTY TO COMPLY WITH CONFLICT-OF INTEREST REQUIREMENTS

ACT SECTION: 502

PRIOR FEDERAL LAW

The normal rules for the taxation of gain or loss would treat the sale of property followed by the reinvestment of the proceeds in other property as two distinct events. The gain or loss on the sale would thus be recognized and taxed to the seller in the year of sale. The purchase of property with the proceeds of sale would start a new holding period and the amount paid for the property would be its initial cost for purposes of determining its adjusted basis for depreciation or subsequent sale.

Several special rollover provisions have been enacted over the years to cover certain kinds of transactions such as property swaps, sale of stock to an employee stock ownership plan (ESOP), sale of a personal residence, sale of a low-income housing project by the owner to its tenants, and involuntary conversions. An involuntary conversion occurs when property, as a result of its destruction, theft, seizure, requisition, or condemnation, is compulsorily or involuntarily converted into property similar to or related in service or use to the property converted. If the property is converted into money and the total proceeds are reinvested in property which is similar or related in service or use to the converted property, then the rollover of gain will be allowed.

These special rollover provisions all provide that specified replacement property be acquired with the proceeds of the sale, that the holding period of the new property include the time the old property was held and that the basis of the new property be reduced by the amount of gain being rolled over.

CURRENT CALIFORNIA LAW (Sec. 18031, 24941-24954, 24990)

California conforms to the federal provisions prior to the enactment of this Act.

NEW FEDERAL LAW (IRC Sec. 1016, (new)1043, 1223)

Provides that when the President or the Director of the Office of Government Ethics issues a certificate of divestiture (which identifies the property to be divested) to an officer or employee (including a spouse, minor child or dependent of the officer or employee) of the executive branch of the Federal Government, the gain on the sale of the property required to be divested is, if so elected, allowed to be rolled over into 'permitted replacement property'. The 'permitted replacement property' can only be an obligation of the United States (i.e., federal bonds) or stock in a diversified investment fund approved by regulations issued by the Office of Government Ethics.

The certificate of divestiture is defined as any written determination that states that divestiture of specific property is reasonably necessary to comply with any Federal conflict of interest statute, regulation, rule, or executive order, or requested by a congressional committee as a condition of confirmation.

The basis of the replacement property is reduced by the amount of gain being rolled over and the holding period of the new property includes the holding period of the property which was required to be divested.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The provisions of this Act apply to sales made after November 30, 1989.

IMPACT ON CALIFORNIA REVENUE

Unknown but probably minor revenue loss in any given year.

TITLE VI: LIMITATIONS ON OUTSIDE EMPLOYMENT AND ELIMINATION OF HONORARIA

ACTION: MODIFY TAX TREATMENT OF CERTAIN AMOUNTS PAID TO CHARITY

ACT SECTION: 602

PRIOR FEDERAL LAW (IRC Sec. 61)

An employee who directs his employer to pay part or all of his compensation to someone else, as in the case of an assignment or direction to pay it over to a union or a charity, realizes income whenever the payment is made or is credited to the account of that party. The Tax Court has indicated that the more relevant tax concept should be who controls the income rather than who receives it. (C. Johnson, 78 TC 882, Dec. 39,069).

The Internal Revenue Service (IRS) has ruled that amounts paid for services rendered are taxable to the individual performing the services, even though paid to a charitable organization, either by agreement between the individual and the payor or by an anticipatory arrangement in which the individual agrees with the organization to render services to it and the organization in turn makes his services available to a third party. (Rev. Rul. 71, 1953-1, CB 18)

In 1979 the IRS ruled that the amount of an honorarium payable to an elected official, but transferred at the official's request to an educational organization selected by the payer from a list of five charitable organizations provided by the official, is includible in gross income. (Rev. Rul. 79-121, 1979-1, CB 61)

Since the honorarium is includible in gross income, the contribution of the amount given to a charitable organization is allowed as an itemized deduction to the individual.

CURRENT CALIFORNIA LAW (Sec. 17071)

California is conformed to the federal provisions prior to the changes made by this Act.

NEW FEDERAL LAW (IRC Sec. 7701)

The Act provides that honoraria which, but for the prohibition contained in Section 601 of the Act, could be made to any officer or employee of the Federal Government but which is made instead on behalf of that person to a charitable organization:

(1) such payment is not to be treated as received by the officer or employee for all purposes of the federal Internal Revenue Code;

(2) such payment is not to be treated as received by the officer or employee for all purposes of any tax law of a State or political subdivision thereof;

(3) no deduction is allowed under the Internal Revenue Code to the officer or employee by reason of having the payment made to the charitable organization; and

(4) no deduction is allowed under any tax law of a State or political subdivision thereof to the officer or employee by reason of having the payment made to the charitable organization.

The above new provision of the Internal Revenue Code preempts any state treatment other than that prescribed in that provision.

EFFECTIVE DATE OF FEDERAL PROVISIONS

This provision of the Act is effective on January 1, 1991.

IMPACT ON CALIFORNIA REVENUE

Negligible revenue impact.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

ACTION: REPEAL OF SPECIAL RULES APPLICABLE TO FINANCIALLY TROUBLED FINANCIAL INSTITUTIONS

ACT SECTION: 1401

PRIOR FEDERAL LAW IRC Sec. 368(a)(3)(D), 382(l)(5)(F), 597

In 1988 TAMRA extended the expiration date of special provisions relating to assistance payments received by financially troubled thrift institutions to December 31, 1989, and broadened those rules to include troubled banks. These special rules provides that:

1) Payments from the Federal Savings and Loan Insurance Corporation (FSLIC) to a financially troubled financial institution are not included in the income of the recipient institution and that payments need not reduce the basis of the acquiring institution. (IRC Sec. 597) However, there may be a reduction in certain tax attributes of a financially troubled financial institution equal to 50 percent of the amount of the financial assistance.

2) Certain FSLIC or FDIC assisted acquisitions involving a financially troubled financial institution may qualify as tax free reorganizations, without regard to the requirement that the shareholders of an acquired corporation must generally maintain a meaningful ownership interest in the acquiring corporation (the continuity of interest requirement) in order for the reorganization to be treated as tax free (IRC Sec. 368).

3) The general limitations on the ability of an acquiring corporation to utilize the net operating losses, built-in losses, and excess credits of a corporation acquired in a tax free reorganization are relaxed in the case of a tax free acquisition of a financially troubled financial institution (IRC Sec. 382).

The IRS takes the position that FSLIC assistance payments that are structured as yield maintenance payments are includible in the recipient's earnings and profits when accrued or received. The committee report indicates that Congress indicated that yield maintenance payments (in the case of thrift institutions which files a consolidated return) are to increase the parent's basis in the stock of the thrift institution equal to yield maintenance payments received.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

REASON FOR CHANGE

Tax subsidy provided to financially troubled financial institutions through favorable tax rules is an inefficient way to provide assistance to those institutions. Prior tax law allowed taxpayers upon acquiring an insolvent financial institution to utilize built-in gains and loss of the insolvent financial institutions to offset tax liabilities.

CURRENT CALIFORNIA LAW (Sec. 23251, 24562(d)(4), 24592)

In 1982 California law (SB 1039, CH.278) conformed to the major corporate reorganization changes made by the federal Bankruptcy Tax Act (BTA) of 1980 (PL. 96-589), which permits the nontaxable transfer of assets of an insolvent corporation under certain circumstances.

The Economic Reform Tax Act (ERTA) of 1982 added Section 368(a)(1)(G) to the Internal Revenue Code to clarify the tax free nature of the reorganization provisions of the BTA.

In 1986, the Tax Reform Act (TRA) replaced the 1981 ERTA language with the code language that existed prior to 1981.

In 1988 California law (SB 573, CH.1068) enacted a special provision to insure that California conformed to the federal provisions relating to reorganizations of insolvent thrift institutions. These provisions allow for financially troubled thrift institutions to qualify for tax-free reorganization, and exempt certain assistance payments made by the FSLIC from taxation. These special rules expired on December 31, 1988.

NEW FEDERAL LAW (IRC Sec. 368(a)(3)(D), 382(1)(5)(F), 597)

The new federal law repeals the special rules provided to acquirors of insolvent financial institutions and directs the Treasury Department to issue regulations providing the rules for the federal income tax treatment of transaction involving financially troubled financial institutions. In addition, the new law provides the following interim rules for all acquisitions occurring on or after May 10, 1989, and before the date on which the Secretary of the Treasury takes action to exercise of the regulatory authority granted by the act.

1. Treatment of acquired financial institutions in taxable asset acquisitions:

The new law provides that federal financial assistance payments will be deemed to have been received by the target institution immediately before the acquisition even if those situations where the assistance is paid directly to the acquiring institution. Most financial assistance received by, or paid with respect to, a financially troubled institution would be taxable, such assistance will be deemed to be received by the financially troubled institution at the time assets of such institution are sold or transferred. As a result, the financial assistance generally will be offset by the net operating losses and built-in losses of the financially troubled institution. Therefore a target institution will have a net tax liability resulting from the receipt of (or deemed receipt) of financial assistance.

2. General rule:

Assistance payments generally will be taxable to the acquiring financial institution only to the extent that the assistance payments exceed the basis properly allocable to such payments. In the case of a taxable assets acquisition, the tax attributes of the corporation whose assets were purchased (including net operating loss deductions, built-in losses, etc.) will be eliminated and the purchase price will be allocated among the various assets acquired in the transaction. In general, such basis allocation shall reflect the fair market values of all assets acquired in the transaction. In the case of assistance payments, the basis allocation shall reflect the economic substance of the various types of assistance payments to be made as set forth below.

3. Negative net worth contributions:

Negative net worth contributions refer to the amounts contributed by the insurer at the time of the acquisition to bring the acquired institution's net worth to zero. The basis will first be allocated to negative net worth contributions and that the amount of basis allocated to such payments will be equal to the amount of the contributions. If negative net worth contributions are made in the form of notes, the amount of basis assigned to the contribution generally will equal the principal amounts of the notes. As a result, neither the receipt of the note nor the payment of the principal amounts will result in the creation of any taxable income to the acquiring institution.

4. Capital loss guarantee and income maintenance agreements relating to specified assets (or pool of assets):

Capital loss guarantees refer to amounts that the insurer promises to pay to the acquiring institution to guarantee that the acquiring institution will receive a designated amount from a specified asset (or pool of assets).

Income maintenance payments refer to payments made by the insurer to insure that the acquiring institution earns a minimum amount of income for a designated period of time from specified assets (or pool of assets). The basis shall be allocated to the specified assets (or pool of assets) in an amount equal to their fair market value as adjusted to reflect the capital loss guarantee and income maintenance agreements applicable to those assets.

The amount received under the capital loss guarantee will be treated as amounts received from the disposition of the guaranteed asset. Thus, in most cases, there will be no taxable income from the receipt of a payment pursuant to a capital loss guarantee and the disposition of the specified asset because the sum of the amount received from the disposition of the asset and the guarantee will not exceed the amount of basis allocated to those assets. Where the amount realized from the disposition of the asset exceeds the amount of basis allocated to those assets (i.e., where the value of the asset has appreciated over the guaranteed value), there will be taxable income because the amount realized from the disposition of the specified asset and the guarantee payments, if any exceeds the basis allocated to those assets.

Expense reimbursements refer to amounts that the insurer pays the acquiring institution to reimburse the acquiring institution for expenses it incurs or will incur in the transaction or in maintaining or disposing of acquired assets. The amount received as expense reimbursement will be includible in gross income, but such income generally would be offset by the deduction arising from expense.

5. <u>Original Issue Obligations:</u>

Interest on deferred payments or original issue discount (OID) that is taxable as interest can arise when payment of any of the above items is deferred through issuance of a note or a deferred payment contract. The amount of OID is the excess of the redemption price at maturity over the amount of any basis allocated to the right to receive future payments.

Original issue discount should result in taxable income. However, whether the principal amount of the notes (as determined under the OID rules) will be taxable to the acquiring institution, will depend on the type of assistance payment which the note represents.

6. <u>Net Operating Loss and Built-In-Losses:</u>

Net operating losses and built-in losses of a financially troubled financial institution may not always be sufficient to offset the amount of financial assistance received (or deemed received) by the troubled institution. This may occur in cases in which the financially troubled thrift was a member of an affiliated group of corporations filing a consolidated return and the net operating losses of such thrift were used to offset the income of other members of the affiliated group. In such a case, the financially troubled thrift may have a net tax liability as a result of receiving financial assistance.

EFFECTIVE DATE OF FEDERAL PROVISIONS

The repeal of the special tax provision relating to treatment of acquisitions as tax-free reorganizations and the relaxation of the limitations on losses and excess credits, is effective for transactions occurring on or after May 10, 1989.

The repeal of the special tax provision relating to the tax-free treatment of assistance payments applies to any amount received or accrued by the financial institution on or after May 10, 1989, except that such repeal does not apply to transfers of financial assistance on or after such date pursuant to acquisitions occurring before May 10, 1989.

The rules applicable to financially troubled financial institutions expired for transactions after December 31, 1989.

IMPACT ON CALIFORNIA REVENUE

Not applicable. California's law for these special rules expired in 1988.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

ACTION: CONFORMING CHANGES APPLICABLE TO FINANCIALLY TROUBLED THRIFT INSTITUTIONS

ACT SECTION: 1401(b)(3)

PRIOR FEDERAL LAW (IRC Sec. 593(e))

Federal law provides that a recapture rule applicable to distributions of property by certain thrift institutions to shareholders, with respect to their stock, does not apply to financially troubled thrift institutions making certain distributions to the Federal Savings and Loan Insurance Corporation (FSLIC).

REASON FOR CHANGE

The new federal law provides for the dissolution of the FSLIC and for the formation of the Resolution Funding Corporation (REFCORP) as the successor of the FSLIC. The present law exception of the recapture rule for repayments to the FSLIC should continue to apply to the new REFCORP entities.

CURRENT CALIFORNIA LAW (Sec. 24322)

California law conformed to prior federal law with regard to the treatment of assistance payments from the FSLIC. The 1988 conformity act expanded the provisions to include banks, and did not extend the expiration date or the provisions of TAMRA of 1988. Current California law expired December 31, 1988.

NEW FEDERAL LAW (IRC Sec. 593(e))

The new federal law amends the IRC Section 593(e) to include the REFCORP entities as the successor to the FSLIC.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Effective August 9, 1989.

IMPACT ON CALIFORNIA REVENUE

None. As a matter of administrative practice, these recapture rules will normally apply for state purposes as well.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

ACTION: CLARIFICATION OF TAMRA OF 1988

ACT SECTION: 1401(c)(7)

PRIOR FEDERAL LAW (IRC Sec. 597)

Under present law, a special tax rule provides that payments from the Federal Savings and Loan Insurance Corporation (FSLIC) or the Federal Deposit Insurance Corporation (FDIC) to a financially troubled financial institution are not included in the income of the recipient institution and that the institution need not reduce its basis in property by the amount of the financial assistance. However, there may be a reduction in certain tax attributes of the recipient of the assistance.

In 1988 the Technical and Miscellaneous Revenue Act (TAMRA) extended this special rule to expire on December 31, 1989, and broaden it to include FDIC assistance and certain FSLIC transactions (involving institutions which did not meet a qualifying asset test), effective for assistance payments made pursuant to acquisitions after November 10, 1988.

REASON FOR CHANGE

Indirect assistance provided through the tax system is inefficient and inequitable. Provisions of the bill allow for direct payments to the acquiring institutions.

CURRENT CALIFORNIA LAW (Sec. 24322)

California Bank and Corporation tax law was amended in 1988 (SB 573, CH.1068) to ensure that state law conformed to federal law with regard to the treatment of assistance payments from FSLIC prior to the enactment of the TAMRA provisions of 1988.

These provisions allowed financially troubled thrift institutions to qualify for tax-free reorganization and to exempt from taxation certain assistance payments made by the FSLIC.

California law did not conform to the extension of the special rules made in TAMRA nor to the expansion of these rules to troubled banks. These special provisions expired on December 31, 1988.

NEW FEDERAL LAW (IRC Sec. 597(c))

The new federal law clarifies that the reduction in tax attributes equal to 50 percent of the amount of nontaxable financial assistance received with respect to FDIC transactions and certain FSLIC transactions (involving institutions which did not meet a qualifying asset test) is effective on the same date that the special tax rule relating to financially troubled financial institutions was extended to such transactions (i.e., acquisitions after November 10, 1988, the date of enactment of the 1988 Act).

EFFECTIVE DATE OF FEDERAL PROVISION

The provision is effective as if included in TAMRA and is retroactively effective November 10, 1988.

IMPACT ON CALIFORNIA REVENUE

Not applicable. California's law pertaining to special tax rules for troubled thrifts expired in 1988.

FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

ACTION: TAX EXEMPTION OF RESOLUTION FUNDING CORPORATION (REFCORP) AND RESOLUTION TRUST CORPORATION (RTC)

ACT SECTION: 1402

BACKGROUND

The provisions of the act abolished the Federal Home Loan Banking Board (FHLBB) and Federal Saving and Loan Insurance Corporation (FSLIC). In addition, the act transferred the insurance function to the Federal Deposit Insurance Corporation (FDIC) and transferred the regulatory function to the Treasury Department (Office of Thrift Supervision). The act creates three new entities to control and manage the remaining assets of the FSLIC. The Oversight Board and the Resolution Trust Corporation (RTC), were created to manage the assets and liabilities of thrift institutions insured by the FSLIC. The Resolution Funding Corporation (REFCORP) will receive funds up to $50 billion of obligations from the FDIC and will be the source of financial assistance paid to acquirors of insolvent thrifts.

The act substantially revises the structure of federal agencies that oversee the activities of the deposits of savings and loan institutions.

PRIOR FEDERAL LAW (IRC Sec. 501(c)(1))

Prior law allowed a federal tax exemption for instrumentalities of the Federal Government. Beginning after July 18, 1984, a tax exemption can only be provided by an amendment to the IRC or by a provision enacted by a revenue act.

Capital assets, reserves, and income of the Federal Home Loan Bank are exempt from federal and state taxation. However, the treatment of interest obligations issued by the Federal Deposit Insurance Corporation (FDIC) are subject to federal and state taxation.

REASON FOR CHANGE

The establishment and purpose of the REFCORP and RTC is to supersede the Federal Saving and Loan Insurance Corporation (FSLIC). The tax exempt benefits enjoyed by the FSLIC are to be awarded to its successors for the successful rehabilitation of the savings and loan industry.

CURRENT CALIFORNIA LAW

California Law does not specifically exempt federal government entities from state taxation. However, state law is preempted by Title 12, Section 1431 esq., of the U.S. Code from taxing the capital assets of the FHLBB. Interest on any obligations issued by the REFCORP or RTC entities is subject to state taxation.

NEW FEDERAL LAW (IRC Sec. 501)

The act amends the IRC to provide the REFCORP and the RTC an exemption from federal income taxation. However, interest on any obligation issued by the RTC or REFCORP entities is subject to federal taxation.

EFFECTIVE DATE OF FEDERAL PROVISIONS

Effective August 9, 1989.

IMPACT ON CALIFORNIA REVENUE

No change would result from current state tax treatment of such entities and the interest earned on obligations issued by them.

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ACT SECTION	FED ACT	IRC SECTION	PITL INSTR	PITL SECTION	BCTL INSTR	BCTL SECTION	EFFECTIVE DATE	DESCRIPTION OF ACT SECTION
7811(a)(1)	A	42(d)(5)(C	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87 in TYBOA 1/1/87	CLERICAL AMENDMENT
7811(a)(2)	A	42(h)(5)(D	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87 in TYBOA 1/1/87	CLERICAL AMENDMENT
7811(b)	A	643(a)(6)	N/A	17731	N/A	N/A	TYBOA 1/1/87	NOT APPLICABLE - Income of Foreign Trusts
7811(c)(1)	A	26(b)(2)	N/A	17039	N/A	23036	TYBOA 1/1/87	NOT APPLICABLE - Definition of FEDERAL tax for purposes of limitations on FEDERAL credits.
7811(c)(2)	A	26(b)(2)	N/A	17039	N/A	23036	TYBOA 1/1/87	NOT APPLICABLE - Definition of FEDERAL tax for purposes of limitations on FEDERAL tax credits.
7811(c)(3)	A	6724(d)(1)(B	N/A	18681.1	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(c)(4)	A	1374(d)(2)(A	CON	17087.5	CON	23800	TYBOA 1/1/87	Clarifies that "S" corporations are permitted to reduce their net built-in gains by any NOL or capital loss carry over from years during which it was a "C" corporation.
7811(c)(5)(A	A	382(h)(6)	N/A	17321	CON	24592	Ownership changes o/a 1/1/87	Items of income or loss that would be treated as built-in gain/loss if recognized within the recognition period are included in computation of net unrealized built-in gain/loss without regard to whether actually recognized during the recognition period.
7811(c)(5)(B	A	1374(d)(5)	CON	17087.5	CON	23800	TYBOA 1/1/87	Items of income or loss that would be treated as built-in gain/loss if recognized within the recognition period are included in computation of net unrealized built-in gain/loss without regard to whether actually recognized during the recognition period.
7811(c)(6)	A	1361(b)(2)(B	CON	17087.5	CON	23800	TYBOA 1/1/87	Clarifies the provision stating that banks and thrifts are not eligible to elect "S" status.
7811(c)(7)	A	1366(f)(2)	CON	17087.5	CON	23800	TYBOA 1/1/87	Clarifies that the amount of any built-in gains tax paid by an S corporation reduces the amount of S corporation income that is taxed to the shareholders.

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ACT SECTION	FED ACT	IRC SECTION	PITL INSTR	PITL SECTION	BCTL INSTR	BCTL SECTION	EFFECTIVE DATE	DESCRIPTION OF ACT SECTION
7811(c)(8)	A	1374(b)(3)(B	CON	17087.5	CON	23800	TYBOA 1/1/87	Clarifies that the minimum tax credit arising in "C" years may also offset the tax on built-in gains during "S" years.
7811(c)(9)	A	8606(a)(3)	CON	17940	CON	24870	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(d)(1)(A	A	59(g)	N/A	17062	N/A	23459	TYBOA 1/1/88	Clarifies authority of Secretary to issue regulations relating to tax benefit rule for purposes of AMT.
7811(d)(1)(B	R	58(h)*ACT*	CON	17062	CON	23400	TYBOA 1/1/88	Clarifies that the repeal of Sec. 58(h) did not affect the authority of the Secretary to take into account preferences arising in TY beginning prior to 1/1/87 in determining tax liabilities for TYBOA 1/1/87.
7811(d)(2)	A	53(d)(1)(B	N/A	17063	N/A	23453	TYBOA 1/1/87	Clarifies that definition of "adjusted net minimum tax" includes any minimum tax imposed as a result of the 90% limitation on foreign tax credits.
7811(d)(3)	A	56(b)(3)	CON	17062	CON	23456	Options exercised o/a 1/1/88	Makes regular tax rules relating to disqualif dispositions (when amount realized is less than value of stock at time of exercise) apply where the stock is disposed of in the same TY that the income is included for AMT purposes.
7811(e)(1)	A	460(a)(2)	CON	17564	CON	24673.2	Contracts entered into after 2/28/86	Clarifies various rules relating to the look-back rules for long-term contracts.
7811(e)(2)	A	460(b)(2)(B	CON	17564	CON	24673.2	Contracts entered into after 2/28/86.	Clarifies various rules relating to the look-back rules for long-term contracts.
7811(e)(3)	A	460(b)(3)	CON	17564	CON	24673.2	Contracts entered into after 2/28/86.	Clarifies various rules relating to the look-back rules for long-term contracts.
7811(e)(4)	A	460(b)(2)	CON	17564	CON	24673.2	Contracts entered into after 2/28/86.	Clarifies various rules relating to the look-back rules for long-term contracts.
7811(e)(5)	A	460(e)(2)	CON	17564	CON	24673.2	Contracts entered into after 2/28/86.	Clarifies exception to long-term contract rules for construction contracts of taxpayers with gross receipts of less than $10 million.
7811(e)(6)	A	460(b)(2)	CON	17564	CON	24673.2	Contracts entered into after 2/28/86.	Clarifies various rules relating to the look-back rules for long-term contracts.

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7811(f)(1)	A	643(a)(6)(A	CON	17731	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(f)(2)	A	265*ACT*	N/A	17280	N/A	24425	Obligations issued after 8/7/86 and before 1/8/87.	CLERICAL AMENDMENT to TAMRA Sec. 1009(b)(3)(B).
7811(g)(1)	A	401(a)	CON	17501	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(g)(2)	A	402(g)(3)	CON	17501	N/A	N/A	Calendar Years BOA 1/1/87	Clarifies regulatory authority with respect to elective deferrals under salary reduction agreements.
7811(g)(3)	A	406(c)	CON	17501	CON	24601	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(g)(3)	A	407(c)	CON	17501	CON	24601	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(g)(4)	A	457(d)(1)(A	CON	17551	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(g)(5)	A	457(d)(2)(B	CON	17551	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(h)(1)	A	409(l)(5)	CON	17501	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(h)(2)	A	129(a)	CON	17131	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT
7811(h)(3)	A	0*ACT*	CON	17501	N/A	N/A	Stock acquired o/a 1/1/87.	CLERICAL AMENDMENT to TAMRA Sec. 1011B(j)
7811(i)(10)	A	883(a)	N/A	N/A	CON	24320	TYBOA 1/1/87	Foreign Corporations - Exclusions from Gross Income.
7811(i)(12)	A	995(g)	N/A	N/A	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT
7811(i)(13)	N	402(e)(7)	N/A	17501	N/A	N/A	TYBOA 1/1/87	Coordination with Limitations on Foreign Tax Credits
7811(i)(14)	A	245*ACT*	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT to TAMRA Sec. 1012(l).
7811(i)(4)	A	1297(b)(5)	N/A	18151	N/A	24995	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(i)(6)(A	A	1446(b)	CON	18807	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT
7811(i)(6)(B	A	1446(d)	N/A	18807	N/A	N/A	TYBOA 1/1/88	Foreign Tax Credits Treated as Distributed to Partner.
7811(i)(6)(C	A	1446(f)	CON	18807	N/A	N/A	TYBOA 1/1/88	Requires Secretary to Issue Regulations Relating to Withholding Tax on Foreign Partners Share of Effectively Connected Income.

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ACT SECTION	FED ACT	IRC SECTION	PITL INSTR	PITL SECTION	BCTL INSTR	BCTL SECTION	EFFECTIVE DATE	DESCRIPTION OF ACT SECTION
7811(i)(7)	A	988(a)	CON	17078	CON	24985	TYBOA 1/1/87	Currency Valuation Rules
7811(j)(1)	A	1(i)(3)	CON	17041	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(j)(3)	A	642(g)	N/A	17731	N/A	N/A	Transfers after 10/22/86	Generation-Skipping Transfers
7811(j)(5)	A	6654(l)(1)	CON	18682	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(j)(6)	A	6654(l)(2)	N/A	18682	N/A	N/A	TYBOA 1/1/87	NOT APPLICABLE - Estates and Trusts
7811(j)(7)	A	59(j)	CON	17062	CON	23459	TYBOA 1/1/88	CLERICAL AMENDMENT
7811(k)(1)	A	6211	N/A	18591.1	N/A	25662.1	Deficiencies mailed after 11-10-88.	CLERICAL AMENDMENT to TAMRA Sec. 1015(r)(3).
7811(k)(2)	A	6502(a)	N/A	18831	N/A	26251	Levies issued after 11/10/88	CLERICAL AMENDMENT
7811(l)	A	514(c)(9)(E	N/A	N/A	CON	23735	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(m)(2)		0*ACT*	N/A	N/A	N/A	N/A	Distributions after 9/30/84	CLERICAL AMENDMENT to TAMRA Sec. 1018(d)(4).
7811(m)(3)		9507(b)*ACT*	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT to TAMRA 1018(u)(20).
7811(m)(4)	A	72(q)(2)(B	CON	17081	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7811(m)(5)	A	414(p)(10)	CON	17501	N/A	N/A	1/1/85	CLERICAL AMENDMENT
7811(m)(6)		425*ACT*	CON	17501	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT to TAMRA Sec. 1018(l)(2).
7811(m)(7)	A	408	CON	17501	N/A	N/A	TYBOA 1/1/89	CLERICAL AMENDMENT
7812(a)		6427(g)(1)	N/A	N/A	N/A	N/A		CLERICAL AMENDMENTS to TAMRA Sec. 2001(d)(7)(C).
7812(b)		3509(d)	N/A	N/A	N/A	N/A		CLERICAL AMENDMENT to TAMRA Sec. 2002(d).
7812(c)		384(e)(1)	N/A	17321	CON	25954	TYBOA 1/1/87	CLERICAL AMENDMENT to TAMRA Sec. 2004.
7812(c)(2)		453A(b)(2)	N/C	17560	N/C	24667		CLERICAL AMENDMENT to TAMRA Sec. 2004.
7813(a)	A	6724(d)(2)	CON	18681.1	N/A	N/A	TYBOA 1/1/89	CLERICAL AMENDMENT
7813(b)		414*ACT*	CON	17501	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT to TAMRA Sec. 3011(b).
7814(a)	R	127(c)(8)	CON	17131	N/A	N/A	TYBOA 1/1/88	Denies an exclusion (for employer provided educational assistance) to graduate teachers research assistants.

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ACT SECTION	FED ACT	IRC SECTION	PITL INSTR	PITL SECTION	BCTL INSTR	BCTL SECTION	EFFECTIVE DATE	DESCRIPTION OF ACT SECTION
7814(b)	A	125(e)(2)(A	CON	17131	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT
7814(c)	A	6045(e)(3)	CON	18802.10	N/A	N/A	Mortgage Credit Certificates Issued After 12/31/90	CLERICAL AMENDMENT
7814(d)	A	46(b)(2)(A	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT to TAMRA Sec. 4006.
7814(e)(1)	A	196(d)	N/A	17201	N/A	N/A	TYBOA 1/1/89	Repeals election to not claim credit with an election to claim a reduced credit.
7814(e)(2)		41(i)	CON	17052.12	CON	23609	TYBOA 1/1/89	
7814(e)(2)(A	N	280C(c)(3)	CON	17270	CON	24440	TYBOA 1/1/89	Repeals the election not to claim a credit with an election to claim a reduced credit.
7814(e)(2)(B		280C(c)(3)	CON	17270	CON	24440	TYBOA 1/1/89	Repeals election to not claim a credit with an election to claim a reduced credit.
7814(e)(2)(C	R	41(h)	CON	17052.12	CON	23609	TYBOA 1/1/89	Repeals the election not to claim a credit with an election to claim a reduced credit.
7814(e)(2)(D	A	196(c)(4)	N/A	17201	N/A	N/A	TYBOA 1/1/89	Repeals the election not to claim a credit with an election to claim a reduced credit.
7814(e)(2)(E	A	6501(n)	N/C	N/C	N/C	N/C	TYBOA 1/1/89	Repeals the election to not claim a credit with an election to claim a reduced credit.
7814(f)	R	67(c)(4)	CON	17076	N/A	N/A	TYBOA 1/1/87	Makes permanent the delay of applying the two percent floor to indirect expenses in connection with dividends received from a mutual fund.
7815(a)(1)	A	7702A(c)(3)B	CON	17020.6	CON	23045	Contracts entered into on or after September 14, 1988.	Modifies definition of "modified endowment contract".
7815(a)(2)		7702A *ACT*	CON	17020.6	CON	23045	Contracts entered into O/A September 14, 1988.	Modifies definition of "modified endowment contract".
7815(a)(3)	A	72(e)(11)A	CON	17081	N/A	N/A	Contracts entered into on or after June 21, 1988.	Technical amendments relating to "modified endowment contracts".

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ACT SECTION	FED ACT	IRC SECTION	PITL INSTR	PITL SECTION	BCTL INSTR	BCTL SECTION	EFFECTIVE DATE	DESCRIPTION OF ACT SECTION
7815(a)(4)	A	7702A(c)(4)	CON	17020.6	CON	23045	Contracts entered into on or after September 14, 1988.	Technical amendments relating to "modified endowment contracts".
7815(a)(5)	A	72(e)(11)A	CON	17081	N/A	N/A	Contracts entered into o/a 6/21/88.	CLERICAL AMENDMENT
7815(b)	A	0*ACT*	N/A	N/A	N/A	N/A	Losses or credits arising after 4/26/88	Alaska Native Corporations
7815(e)(1)	A	460(e)(6)(A	N/C	17564	N/C	24673.2	Contracts entered into o/a 6/21/88.	Technical amendments relating to percentage of completion method of accounting for long-term contracts.
7815(e)(2)	A	56(a)(3)	CON	17062	CON	23456	Contracts entered into o/a 6/21/88.	CLERICAL AMENDMENT
7815(e)(3)		460 *ACT*	N/C	17564	N/C	24673.2	Contracts entered into o/a 6/21/88.	Technical amendment to effective dates of TAMRA Sec. 5041.
7815(e)(4)	A	56(g)(4)(D	N/A	17062	CON	23456	TYBOA 1/1/88	CLERICAL AMENDMENT
7815(g)	A	453A (b)(3)	N/C	17560	N/C	24667	Dispositions o/a 1/1/89	Provides that the sale of personal use property by an individual is not subject to the special installment sale rules that generally apply to a nondealer sale of property with a sales price in excess of $150,000.
7815(h)	A	382(1)(3)(C	N/A	N/A	CON	24592	Dispositions in TYBOA 1/1/88	CLERICAL AMENDMENT
7816(a)	A	274(n)(2)	CON	17201	CON	24443	TYBOA 1/1/88	Amendments Related to Section 6003 of the 1988 Act
7816(b)	A	1(i)(7)(A	CON	17041	N/A	N/A	TYBOA 1/1/89	CLERICAL AMENDMENT
7816(c)	A	135(d)(1)	CON	17131	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT
7816(d)	A	263A(h)(3)D	N/A	17261	CON	24422.3	Costs incurred o/a 1/1/87	CLERICAL AMENDMENT
7816(e)(1)	A	168(c)(2)	CON	17201	CON	23802	Property Placed in Service o/a 1/1/89	CLERICAL AMENDMENT

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ACT SECTION	FED ACT	IRC SECTION	PITL INSTR	PITL SECTION	BCTL INSTR	BCTL SECTION	EFFECTIVE DATE	DESCRIPTION OF ACT SECTION
7816(e)(2)	A	168(b)(5)	CON	17201	CON	23802	Property Placed in Service o/a 1/1/89	CLERICAL AMENDMENT
7816(f)	A	168(b)(3)	CON	17201	CON	23802	Property Placed in Service o/a 1-1-89	CLERICAL AMENDMENT
7816(g)		451(d)*ACT*	CON	17551	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT to TAMRA Sec. 6033(b).
7816(h)		415(b)*ACT*	CON	17501	N/A	N/A	TYBOA 1/1/88	CLERICAL AMENDMENT to TAMRA Sec. 6054(b)(1).
7816(i)		852(b)*ACT*	CON	17088	CON	24412	TYBOA 1/1/88	CLERICAL AMENDMENT to TAMRA Sec. 6061.
7816(j)	A	457(e)(13)	CON	17551	N/A	N/A	TYBOA 1/1/88	Clarifies exemption for churches from rules relating to unfunded deferred compensation plans.
7816(k)		414(1)*ACT*	CON	17501	N/A	N/A		CLERICAL AMENDMENT to TAMRA Sec. 6067(c).
7816(1)		401(k)*ACT*	CON	17201	N/A	N/A	TYBOA 11/11/88.	CLERICAL AMENDMENT to TAMRA Sec. 6071(b)(2).
7816(m)		481*ACT*	CON	17551	CON	24721	TYBOA 1/1/87	Clarifies Application of IRC Sec. 481.
7816(u)	N	7521	N/A	N/A	N/A	N/A	Interviews after 2/10/89.	Procedures Relating to Taxpayer Interviews.
7816(u)	R	7520	N/A	N/A	N/A	N/A	Interviews after 2/10/89	Procedures Relating to Taxpayer Interviews.
7816(v)	A	6713	N/A	N/A	N/A	N/A	Disclosures o/a 1/1/89	Disclosure or Use of Information by Preparers of Tax Returns
7816(v)	R	6712	N/A	N/A	N/A	N/A	Disclosures o/a 1/1/89.	Disclosure or Use of Information by Preparers of Tax Returns.
7816(w)	A	168(i)*ACT*	CON	17201	CON	23802	Property placed in service o/a 1/1/87.	CLERICAL AMENDMENT to TAMRA Sec. 6253.
7821(a)(1)	A	453A(b)(2)B	N/C	17560	N/C	24667	Dispositions in TYBOA 1/1/88	CLERICAL AMENDMENT
7821(a)(2)	A	453A(d)(2)B	N/C	17560	N/C	24667	Dispositions in TYBOA 1/1/88	Technical amendments related to pledges of installment obligations.
7821(a)(3)	A	453A(d)(1)B	N/C	17560	N/C	24667	Dispositions in TYBOA 1/1/88	CLERICAL AMENDMENT

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7821(a)(4)(A	A	26(b)(2)	N/A	17039	N/A	23036	Dispositions in TYBOA 1/1/88	Modifies definition of FEDERAL tax for purposes of limiting FEDERAL tax credits.
7821(a)(4)(B	N	453A(c)(5)	N/C	17560	N/C	24667	Dispositions in TYBOA 1/1/88	Provides that interest paid on the deferral of tax for installment sales qualifies as deductible interest expense.
7821(a)(5)	A	56(a)(6)	CON	17062	CON	23456	Dispositions in TYBOA 1/1/88	CLERICAL AMENDMENT
7821(b)	A	7519(d)(4)	N/C	N/C	N/C	N/C	TYBOA 1/1/89	Technical amendments related to "required payments" for entities retaining a fiscal accounting period.
7821(c)	A	1503(e)	N/A	N/A	N/A	23364	Dispositions after 12/15/87	CLERICAL AMENDMENT
7822(a)	A	6655(e)(1)	N/A	N/A	N/A	25951	TYBOA 1/1/88	CLERICAL AMENDMENT
7822(b)	A	6427	N/A	N/A	N/A	N/A	TYBOA 1/1/88	Technical amendments related to Section 10502 of the 1987 Revenue Act.
7822(c)	A	90*ACT*	CON	17081	CON	24276	TYBOA 1/1/88	CLERICAL AMENDMENT
7822(d)	A	7611(i)(3)	N/A	N/A	N/A	N/A	TYBOA 1/1/88	Technical amendments related to restrictions on inquiries and examinations of churches.
7831(a)	A	1(f)(6)(B	N/A	17041	N/A	N/A	TYBOA 1/1/89	NOT APPLICABLE - Federal Rounding
7831(b)	A	1250(b)(5)	CON	18151	CON	24990	TYBOA 1/1/87	CLERICAL AMENDMENT
7831(c)(1)	A	42(i)(3)	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87.	Adds reference to regulations.
7831(c)(2)	N	42(i)(3)(D	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87.	Provides that occupation by individuals in government supported job training programs will not disqualify the unit from the low-income housing credit.
7831(c)(3)	N	42(i)(6)	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87.	Adds rules relating to estates and trusts.
7831(c)(4)	N	42(f)(4)	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87.	Provides rules for allocation of low-income housing credit in year of disposition.

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7831(c)(5)	N	42(m)(4)	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87.	Technical amendments relating to correction of administrative errors and omissions.
7831(c)(6)	A	42(d)(7)	DEF	17058	DEF	23610.5	Buildings placed in service o/a 1/1/87	CLERICAL AMENDMENT
7831(d)		263A *ACT*	CON	17201	CON	24422.3	Costs incurred o/a 1/1/87	Clarifies that interest incurred after 12/31/86 is subject to capitalization, even though attributable to costs incurred prior to 1/1/87. Does not alter transition relief provisions.
7831(e)		0*ACT*	N/A	N/A	N/A	N/A	Laws enacted after 10/22/86.	Tax-Exempt Bonds
7831(f)		406(b)*ACT*	CON	17501	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(a)(1)	A	408(d)(6)	CON	17501	N/A	N/A	TY ending after 12/19/89.	Amends rule relating to transfers of interests in an IRA incident to a divorce to conform to the treatment generally of such transfers under qualified plans.
7841(a)(2)	N	414(p)(11)	CON	17501	N/A	N/A	Transfers made after 12-19-89	Amends rules relating to transfers of interests in governmental or church plans to conform generally to the tax rules applicable to other qualified plans.
7841(b)	A	404(g)(1)	CON	17501	CON	24601	Payments after 1/1/86.	Amends rule relating to deduction of employer liability payments treated as contributions to qualified plans to clarify that the rule applies in the case of standard terminations.
7841(c)	A	219(f)(1)	CON	17201	N/A	N/A	Contributions made after 12/19/89.	Modifies definition of compensation (for purposes of IRA) to include certain earned income not subject to FICA or SECA.
7841(d)(1)	A	6103(d)(1)	N/A	19286	N/A	26453c	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(10)	A	381(a)(27)	CON	17321	CON	24591	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(11)	A	382(1)(3)(B	N/A	17321	CON	24592	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(12)	A	6157(a)	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(13)	A	42(d)(6)(A	DEF	17058	DEF	23610.5	TYBOA 1/1/87	CLERICAL AMENDMENT

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7841(d)(14)	A	42(d)(7)(A	DEF	17058	DEF	23610.5	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(15)	A	42(e)(2)(A	DEF	17058	DEF	23610.5	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(18)	A	274(n)(2)(F	CON	17201	CON	24443	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(19)	A	132(f)(2)(B	CON	17131	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(2)	A	6871	N/A	18649	N/A	25672	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(20)	A	6420(e)(2)	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(20)	A	6421(g)(2)	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(20)	A	6427(j)(2)	N/A	N/A	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(3)	A	691(c)(5)	CON	17731	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(5)(A	A	6652	N/A	18681.1	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(6)	A	410(a)(2)	CON	17501	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(7)	A	132(h)(1)	CON	17131	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(d)(8)	A	66(d)(1)	N/A	18408.2	N/A	N/A	TYBOA 1/1/87	CLERICAL AMENDMENT
7841(e)	A	597(b)(2)	N/A	N/A	N/C	24322	Transactions o/a 5/10/89.	Modifies rules relating to FISLIC and FDIC bailout payments.
7841(f)	A	6091(b)(6)	N/A	18431	N/A	25405	TYBOA 1/1/87	CLERICAL AMENDMENT relating to alcohol, tobacco, and firearms.
7841(g)		0*ACT*	N/A	N/A	N/A	N/A	TYBOA 1/1/89	Payments from Vaccine Injury Compensation Trust Fund.
7861(a)	A	411(a)	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to minimum vesting standards.
7861(c)	A	0*ACT*	CON		CON		Plan years BOA 1/1/89	Technical amendments related to Sec. 1140 of the 1986 Tax Reform Act, relating to plan amendments o/a/ 1/1/89.
7861(d)	A	0*ACT*	CON		CON		Plan years BOA 1/1/85	TECHNICAL AMENDMENT to Sec. 1145 of the Tax Reform Act of 1986, relating to joint and survivor annuities.
7862(a)	A	0*ACT*	CON		CON		Plan years BOA 1/1/75	TECHNICAL AMENDMENT to Sec. 1852 of the Tax Reform Act of 1986.

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7862(b)	A	0*ACT*	CON		CON		Plan years BOA 1/1/86	Technical amendments related to single employer pension plans.
7862(c)(1)	A	106(b)(2)	CON	17131	N/A	N/A	TYBOA 1/1/87	Technical amendments related to Section 1895 of the 1986 Tax Reform Act, relating to continutation coverage under group health plans.
7862(c)(3)	A	162(k)(2)	CON	17201	CON	24343	Plan years BOA 1/1/90	Technical amendments related to Sec. 1895 of the 1986 Tax Reform Act, relating to continuation coverage under group health benefit plans.
7862(c)(6)		0*ACT*					TYBOA 1/1/89	Technical amendments related to Sec. 1895 of the 1986 Tax Reform Act, relating to continuation coverage under group health benefit plans.
7862(d)	A	417(a)(3)(B	CON	17501	N/A	N/A	Distributions after 10/22/86	Technical amendments related to Section 1898 of the 1986 Tax Reform Act.
7871(a)	A	411(b)(2)	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Section 9202 of 1986 OBRA, relating to benefit accruals beyond normal retirement age.
7871(b)	A	411(a)(8)	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Section 9203 of 1986 OBRA, relating to definition of normal retirement age.
7871(c)		0*ACT*	N/A	N/A	N/A	N/A	Plan years BOA 1/1/89	CLERICAL AMENDMENT
7881(a)(1)	A	412(l)(3)(C	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9303 of the Pension Protection Act, relating to additional funding requirements for defined benefit plans.
7881(a)(2)	A	412(l)(4)(B	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9303 of the Pension Protection Act, relating to additional funding requirements for defined benefit plans.
7881(a)(3)	A	412(l)(5)(C	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9303 of the Pension Protection Act, relating to additional funding requirements for defined benefit plans.
7881(a)(4)	A	412(l)(7)(D	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9303 of the Pension Protection Act, relating to additional funding requirements for defined benefit plans.
7881(a)(5)	A	412(l)(8)(E	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9303 of the Pension Protection Act, relating to additional funding requirements for defined benefit plans.

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7881(a)(6)	A	412(c)(9)	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Section 9303 of Pension Protection Act, relating to additional funding requirements for defined benefit plans.
7881(a)(7)		0*ACT*	CON		N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9303 of the Pension Protection Act, relating to additional funding requirements for defined benefit plans.
7881(b)	A	412(c)(10)A	CON	17501	N/A	N/A	12/19/89	Technical amendments related to Section 9304 of Pension Protection Act
7881(b)	A	412(m)(1)	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Section 9304 of Pension Protection Act, relating to quarterly estimated payments.
7881(b)	A	412(d)(1)(A	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9304 of the Pension Protection Act, relating to quarterly estimated payments.
7881(b)	A	412(m)(4)(D	CON	17501	N/A	N/A	Plan years BOA 1/1/89	Technical amendments related to Sec. 9304 of the Pension Protection Act, relating to quarterly estimated payments.
7881(c)	A	412(f)(4)(A	CON	17501	N/A	N/A	Applications submitted o/a 1/1/88	Technical amendments related to Section 9306 of Pension Protection Act, relating to funding waivers.
7881(d)	A	412(b)(5)(B	CON	17501	N/A	N/A	Plan yers BOA 1/1/88	Technical amendments related to Section 9307 of Pension Protection Act, relating to limitations on interest rates.
7881(e)	A	0*ACT*					Plan terminations after 12/17/87	Technical amendments related to Section 9311 of Pension Protection Act, relating to employer reversions.
7881(f)	A	0*ACT*					Plan terminations after 12/17/87	Technical amendments related to Section 9312 of Pension Protection Act, relating to plan terminations.
7881(g)	A	0*ACT*					Plan terminations after 12/17/87	Technical amendments related to Section 9313 of Pension Protection Act, relating to standards for termination.
7881(h)	A	0*ACT*					Plan years BOA 1/1/88	Technical amendments related to Section 9331 of Pension Protection Act, relating to PBGC premiums.
7881(i)	A	401(a)(29)	CON	17501	N/A	N/A	Plan changes after 12/22/87	Technical amendments related to Section 9341 of Pension Protection Act, relating to underfur plans.

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7881(j)	A	0*ACT*					Reports filed after 12/31/87	Technical amendments related to Section 9342 of Pension Protection Act, relating to reports of unfunded liabilities.
7881(k)	A	0*ACT*					12/22/87	Technical amendments related to Section 9343 of Pension Protection Act, relating to return of employer contributions.
7881(l)	A	0*ACT*					Plan changes after 12/17/87	Technical amendments related to Section 9345 of Pension Protection Act, relating to prohibited transactions.
7881(m)	A	411(a)(7)	CON	17501	N/A	N/A	Plans years BOA 1/1/88	Technical amendments related to Section 9346 of Pension Protection Act, relating to required interest rate on mandatory employee contributions.
7881(m)	A	411(c)(2)(C	CON	17501	N/A	N/A	Plan years BOA 1/1/88	Technical amendments related to Sec. 9346 of the Pension Protection Act, relating to required interest rate on mandatory employee contributions.
7891	A	0*ACT*					Plan years BOA 1/1/88	Additional technical amendments Related to the Tax Reform Act of 1986.
7892	A	0*ACT*					Plan years BOA 1/1/88	Additional technical amendments Relating to the Pension Protection Act.
7893	A	0*ACT*					Plan years BOA 1/1/88	Additional technical amendments Relating to the Single Employer Pension Plan Amendments Act of 1986.
7894	A	0*ACT*					Plan years BOA 1/1/88	Additional technical amendments to ERISA.
10201(b)(1)		406(a)	N/A	17501	N/A	N/A	6/15/89	CLERICAL AMENDMENTS
10210(b)(2)		406(c)	N/A	17501	N/A	N/A	6/15/89	CLERICAL AMENDMENTS