California
Franchise
Tax
Board

SUMMARY OF FEDERAL INCOME TAX CHANGES—1993

Laws Affected
Personal Income Tax
Bank & Corporation Tax

SUMMARY OF
FEDERAL INCOME TAX CHANGES
1993

Prepared by the Staff of the
FRANCHISE TAX BOARD
State of California

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

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REVENUE RECONCILIATION ACT OF 1993 (P.L. 103-66)

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Executive Summary

On August 10, 1993, the President signed the Omnibus Budget Reconciliation Act (OBRA) of 1993. The part of OBRA 93 relating to income tax is called the Revenue Reconciliation Act of 1993 and is the subject of this report. Over 80 separate provisions are examined by explaining the federal law as it existed prior to the change, the current California law relating to the area being changed by federal law, a discussion of the change extracted from the House, Senate and Conference Committee reports, the effective date of the new federal law and the impact on California revenue were California to conform to the new federal law. Also contained in the explanations are citations to the section numbers of the Act as well as the Internal Revenue Code and California Revenue and Taxation Code sections impacted by the change.

Most of the federal tax law changes are not effective until January 1, 1994. However, increases in the top individual and corporate tax rates and alternative minimum tax rates are retroactive to January 1, 1993. In addition, changes in the amount of depreciable property eligible for immediate expensing under Section 179 are effective for property placed in service in taxable years beginning on or after January 1, 1993. Provisions which had expired on June 30, 1992, including the deductions for employee educational assistance and self-employed health insurance, as well as the credits for research and development and low income housing credits, were retroactively reinstated and extended.

Although most of the changes relate to raising revenue, certain provisions which either encourage small business activity or reduce burdens for small business were enacted. These include provisions allowing for the first time the amortization of intangible business assets, increasing the expensing deduction on tangible business assets for small business from $10,000 to $17,500, a 50% exclusion from income of capital gain from the sale of qualified small business stock acquired after August 10, 1993, and held for more than 5 years and rollover of gain treatment for investments in specialized small business investment companies. Relief was also provided to the real estate industry in the form of eased passive loss rules for real estate professionals and incentives to encourage pension fund investment in real estate.

Also for the first time, several tax incentives are provided for companies that invest on Indian reservations or in urban or rural empowerment zones that will be designated by the federal government in 1994.

Exhibit A contains a list of expiring provisions in both California and federal law for the years 1993 through 1999.

As shown in Exhibit A, the following California provisions expired in 1993:

Tax Credit - Solar energy devices

Tax Credit - Recycling equipment

Tax Credit - Parent who stays at home

Tax Credit - Targeted jobs

Deduction - Self-employed health insurance

Deduction - Contribution of technological equipment to schools

Exhibit A also shows that the following provisions will expire in 1994 without legislative action:

Administration - Settlement Authority

Tax Credit - Start-up costs for employer-provided child care center

Tax Credit - Employer-provided child care plan

Tax Credit - Renters (no credit for 1993 or 1994, but resumes in 1995)

Exclusion - Energy conservation subsidies

Exclusion - Employer-provided educational assistance

Deduction - Contributions of stock for which market quotations are readily available

Deduction - Expensing of clean fuel property

Exclusion - Sale of stock to an ESOP

Exclusion - Interest on loans to ESOPs

Exclusion - Dividends paid to an ESOP

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SUMMARY OF REVENUE IMPACT

Section	Title of Section	1994-5 ($millions)
13101	Employer Provided Educational Assistance	(A)
13102	Targeted Jobs Credit	-1
13111	Extension of Research and Clinical Testing Credits	-1
13112	Modification of Fixed Base Percentage for Startup Companies	N/A
13113	50-percent Exclusion for Gain From Certain Small Business Stock	N/A
13114	Rollover of Gain from Sale of Publicly Traded Securities Into Specialized Small Business Investment Companies	-1
13115	Modification to Minimum Tax Depreciation Rules	-10
13116	Increase In Expense Treatment For Small Business	-30
13121	High-speed Intercity Rail Facility Bonds Exempt from State Volume Cap	N/A
13122	Permanent Extension of Qualified Small Issue Bonds	N/A
13131	Expansion and Simplification of Earned Income Tax Credit	N/A
13141	Permanent Extension of Qualified Mortgage Bonds	N/A
13142	Low-Income Housing Credit	(B)
13143	Application of Passive Loss Rules to Rental Real Estate Activities	-20
13144	Real Estate Property Acquired by a Qualified Organization (Includesn Act Section 13144 through 13149)	-5
13145	Repeal of Special Treatment of Publicly Traded Partnerships (Included in Act Section 13144)	-
13146	Title-holding Companies Permitted to Receive Small Amounts of Unrelated Business Taxable Income (Included in Act Section 13144)	-

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Section	Title of Section	1994-5 ($millions)
13147	Exclusion From Unrelated Business Tax Of Gains From Certain Property (Included in Act Section 13144)	-
13148	Exclusion From Unrelated Business Tax Of Certain Fees And Option Premiums (Included in Act Section 13144)	-
13149	Treatment of Pension Fund Investments in Real Estate Investment Trusts (Included in Act Section 13144)	-
13150	Exclusion From Gross Income For Income From Discharge Of Qualified Real Property Business Indebtedness	-4
13151	Increase In Recovery Period For Nonresidential Real Property	1
13161	Repeal of Luxury Excise Tax Other Than on Passenger Vehicles	N/A
13162	Exemption From Luxury Excise Tax For Certain Equipment Installed on Passenger Vehicles For Use by Disabled Individuals	N/A
13163	Tax on Diesel Fuel Used in Non-commercial Boats	N/A
13171	Alternative Minimum Tax Treatment Of Contributions Of Appreciated Property	-5
13172	Substantiation Requirement For Deduction of Certain Charitable Contributions (Includes Act Section 13173)	(C)
13173	Disclosure Related to Quid Pro Quo Contributions (Included in Act Section 13172)	-
13174	Temporary Extension of Health Insurance Deduction for Self-Employed Individuals	(D)
13201	Increase In Top Marginal Rate Under Section 1	N/A
13202	Surtax on High Income Taxpayers	N/A
13203	Modifications to Alternative Minimum Tax Rates and Exemption Amounts	-120

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SUMMARY OF REVENUE IMPACT

Section	Title of Section	1994-5 ($millions)
13204	Overall Limitation on Itemized Deductions For High-income Taxpayers Made Permanent	N/A
13205	Phaseout of Personal Exemption of High-income Taxpayers Made Permanent	N/A
13206(a)	Interest Imbedded In Financial Transactions (Includes Act Section 13206 (a) through (e)	1
13206(b)	Repeal of Certain Exceptions to the Market Discount Rules (Included in Act Section 13206 (a))	-
13206(c)	Accrual of Income by Holders of Stripped Preferred Stock (Included in Act Section 13206 (a))	-
13206(d)	Treatment of Net Capital Gains as Investment Income (Included in Act Section 13206 (a))	-
13206(e)	Treatment of Certain Appreciated Inventory (Included in Act Section 13206 (a))	-
13207	Repeal of Limitation on Amount of Wages Subject to Health Insurance Employment Tax	N/A
13208	Top Estate And Gift Tax Rates Made Permanent	N/A
13209	Reduction in Deductible Portion of Business Meals And Entertainment	N/A
13210	Elimination Of Deduction For Club Membership Fees	10
13211	Disallowance of Deduction For Certain Employee Remuneration in Excess of $1,000,000	2
13212	Reduction in Compensation Taken Into Account in Determining Contributions And Benefits Under Qualified Retirement Plans	(E)
13213	Modifications to Deduction For Moving Expenses	25
13214	Simplification of Individual Estimated Tax Safe Harbor Based on Last Year's Tax	-55
13215	Social Security And Tier I Railroad Retirement Benefits	N/A
13221	Increase In Top Marginal Rate Under Section 11	N/A

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Section	Title of Section	1994-5 ($millions)
13222	Denial of Deduction for Lobbying Expenses	6
13223	Mark-to-Market Accounting Method For Securities Dealers	10 (F)
13224	Clarification Of Treatment of Certain FSLIC Financial Assistance	-
13225	Modification of Corporate Estimated Tax Rules	17
13226	Modifications of Discharge of Indebtedness Provisions	Minor Gain
13227	Limitation on Section 936 Credit	N/A
13228	Modification to Limitation on Deduction For Certain Interest	3
13231 -13233	Current Taxation Of Certain Earnings Of Controlled Foreign Corporations	-
13234	Allocation of Research and Experimental Expenditures	Minor Gain
13235	Eliminate Working Capital Exception for Foreign Oil and Gas and Shipping Income	N/A
13236	Modifications Of Accuracy-Related Penalty	Minor Gain
13237	Denial Of Portfolio Interest Exemption For Contingent Interest	N/A
13238	Regulations Dealing With Conduit Arrangements	(G)
13239	Treatment Of Export of Certain Softwood Logs	Minor Gain
13241 -13245	Transportation Fuels Provisions	N/A
13251	Modifications to Substantial Understatement Penalty	Insignificant Gain
13252	Returns Relating to The Cancellation of Indebtedness by Certain Financial Entities	(H)
13261	Amortization of Goodwill and Certain Other Intangibles	(I)

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Section	Title of Section	1994-5 ($millions)
13262	Treatment of Certain Payments To Retired Or Deceased Partner	2
13271	Disallowance of Interest on Certain Overpayments of Tax	Minor Gain
13272	Denial of Deduction Relating to Travel Expenses	1
13273	Increase in Withholding From Supplemental Wage Payments	N/A
13301 -13303	Empowerment Zones, Enterprise Communities, Rural Development Investment Areas, Etc.	N/A
13311	Credit For Contributions to Certain Community Development Corporations	N/A
13321 -13322	Tax Incentives for Businesses on Indian Reservations	N/A
13401 -13403	Disclosure of Return Information For Purposes of Veterans Programs, Repayment of Student Loans and Verification Under Certain Housing Assistance Programs	N/A
13411	Increase In Public Debt Limit	N/A
13421 -13422	Vaccine Provisions	N/A
13431	Modification Of Involuntary Conversion Rules For Certain Disaster Related Conversions	N/A
13441	Increase in Presidential Election Campaign Check-off	N/A
13442	Special Rule For Hospital Services	Insignificant Gain
13443	Credit For Portion of Employer Social Security Taxes Paid With Respect to Employee Cash Tips	N/A
13444	Availability And Use of Death Information	N/A
	TOTAL	$-174

N/A = Not Applicable
Minor Loss = Less than $1 million
Minor Gain = Less than $1 million

(A) Baseline revenue loss of $20 million annually.

(B) Baseline revenue loss of $35 million annually due to Federal extension.

(C) Baseline revenue gain of $5 million annually.

(D) Retroactive loss is estimated at $30 million.

(E) Baseline revenue gain of $20 million annually.

(F) An additional baseline revenue gain of $10 million will occur.

(G) Requires Treasury regulations.

(H) Baseline revenue gain of $5 million annually.

(I) A baseline net revenue gain annually in the $10-20 million range.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

A-I: Training And Investment Incentives - Provisions Relating To Education And Training

Public Law: 103-66

Act Section: 13101

Section Title: Employer Provided Educational Assistance

Prior Federal Law (Sec. 127(d) and 132(i))

Prior to July 1, 1992, an employee's gross income and wages for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. This exclusion, which expired with respect to amounts paid after June 30, 1992, was limited to $5,250 of educational assistance with respect to an individual during a calendar year. Education that did not qualify for the exclusion (e.g., because it exceeded the $5,250 limit) was excludable from income if and only if it qualified as a working condition fringe benefit. To be excluded as a working condition fringe, the cost of the education must have been a job-related deductible expense.

In the absence of the exclusion, for purposes of income and employment taxes, an employee generally is required to include in income and wages the value of educational assistance provided by the employer unless the cost of such assistance qualifies as a deductible job-related expense of the employee.

Current California Law (Sec. 17131 and 17151)

California is conformed to the federal provisions that pertain to the exclusion of employer-provided educational benefits, with one exception.

California deliberately enacted a provision to make the federal provision relating to the termination date inapplicable. Instead, California specifically provides that the state exclusion is permanent, but available only in those taxable years (or portion thereof) that an exclusion is applicable for federal purposes. This means that any extension of the federal exclusion extends the existing state provision. However, if federal law includes changes other than an extension of the existing exclusion, the other changes do not become state law until such time as the Legislature enacts conforming legislation.

New Federal Law (Sec. 127(d))

The exclusion for employer-provided educational assistance is extended retroactively and through December 31, 1994.

It is intended that the Secretary use his existing authority to the fullest extent possible to alleviate any administrative problems that may result from the expiration and retroactive extension of the exclusion and to facilitate in the simplest way possible the recoupment of excess taxes paid with respect to educational assistance provided in the last half of 1992.

Also, the rule under which educational assistance that does not satisfy the limitations specified in Section 127 of the Internal Revenue Code may be excluded from income if and only if it meets the requirements of a working condition fringe benefit is clarified.

Effective Date of New Federal Law

The extension of the exclusion is effective for taxable years ending after June 30, 1992. The clarification to the working condition fringe benefit rule is effective for taxable years beginning after December 31, 1988.

Impact on California Revenue

This provision is automatically extended under current state law; the baseline revenue loss is in the $20 million range for the 1994-5 fiscal year.

A-I: Training And Investment Incentives - Provisions Relating To Education And Training

Public Law: 103-66

Act Section: 13102

Section Title: Targeted Jobs Credit

Prior Federal Law (Sec. 51)

Prior to July 1, 1992, the targeted jobs tax credit was available to employers on an elective basis for hiring individuals from several targeted groups. The targeted groups consist of individuals who are either recipients of payments under means-tested transfer programs, economically disadvantaged, or disabled.

The credit generally is equal to 40 percent of up to $6,000 of qualified first-year wages paid to a member of a targeted group. Thus, the maximum credit generally is $2,400 per individual. With respect to economically disadvantaged summer youth employees, however, the credit is equal to 40 percent of up to $3,000 of wages, for a maximum credit of $1,200.

The credit expired for individuals who began work for an employer after June 30, 1992.

Current California Law (Sec. 17053.7 & 23621)

The state credit differs significantly from the federal credit. California allows a credit equal to 10 percent of wages paid by an employer to each employee certified as eligible by the Employment Development Department. Eligible wages are limited to $3,000 paid by the employer per year for the first 24 months but the maximum credit is $600 for each qualified employee.

The state credit expires for individuals who begin work for an employer after December 31, 1993.

New Federal Law (Sec. 51)

The Revenue Reconciliation Act of 1993 extends for 30 months the targeted jobs tax credit for individuals who begin work for the employer after June 30, 1992, and on or before December 31, 1994.

Effective Date of New Federal Law

The extension of the targeted jobs tax credit is effective for individuals who begin work for the employer after June 30, 1992, and before December 31, 1994.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

If California were to extend its targeted jobs tax credit, the revenue loss is estimated to be $1 million annually.

A-II-A: Training And Investment Incentives - Investment Incentives - Research And Clinical Testing Credits

Public Law: 103-66

Act Section: 13111-13112

Section Title: Extension of Research and Clinical Testing Credits and Modification of Fixed Base Percentage for Start-up Companies

Prior Federal Law (Sec. 28 and 41)

The research and experimentation tax credit ("research tax credit") provides a credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceed its base amount for that year. The credit expired after June 30, 1992.

The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984-1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (such as "start-up" firms) are assigned a fixed-base percentage of .03.

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

Qualified research expenditures eligible for the credit consist of: (1) "in-house" expenses of 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. The credit is not available for expenditures attributable to research that is conducted outside the United States. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

The 20-percent research tax credit also applies to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain scientific research organizations) OVER (2) the sum of (a) the greater of two fixed research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation.

Deductions for expenditures allowed to a taxpayer under Section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year.

The orphan drug tax credit provides a 50 percent nonrefundable tax credit for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases, generally referred to as "orphan drugs." The orphan drug tax credit expired after June 30, 1992.

Current California Law (Sec. 17052.12 & 23609)

California confors to the federal research credit provisions with the following modifications:

1. "Qualified" Research Expenses.

   A. Percentage. This portion of the credit is equal to 8 percent of the excess of the "qualified" research expenses in California over a "base amount."

   B. Base Amount. Defines gross receipts for purposes of computing the base period amount as sales that would be included in the numerator of the California sales factor for income apportionment purposes.

2. "Basic" Research Payments.

   A. Percentage. This portion of the credit is equal to 12 percent of the excess of "basic research payments" in California over the "qualified organization base period amount."

   B. Applied Research. "Basic Research Payments" also includes amounts paid for applied research, including scientific inquiry or original investigation for the advancement of scientific or engineering knowledge or the improved effectiveness of commercial products (excluded for federal purposes).

For taxable or income years beginning on or after January 1, 1994, SB 671 (Stats. 1993, Ch. 881) also conformed California law to the amendments made to the research credit by the Revenue Reconciliation Act of 1993 relating to the new fixed-base percentage calculation for start-up companies.

The California Orphan Drug credit expired at the end of 1992.

New Federal Law (Sec. 41)

The research tax credit (including the university basic research credit) is extended for three years (i.e., for expenditures paid or incurred during the period July 1, 1992, through June 30, 1995).

The Revenue Reconciliation Act of 1993 also adds a new rule regarding the determination of the fixed-base percentage of start-up firms. Under the provision, a taxpayer that did not have gross receipts in at least three years during the 1984-1988 period will be assigned a fixed base percentage of .03 for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. The taxpayer's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurred qualified research expenditures will be as follows: (1) for the taxpayer's sixth year, its fixed-base percentage will be one-sixth of its ratio of qualified research expenditures to gross receipts for its fourth and fifth years; (2) for its seventh year, its fixed-base percentage will be one-third of its ratio for its fifth and sixth years; (3) for its eighth year, its fixed-base percentage will be one-half of its ratio for its fifth through seventh years; (4) for its ninth year, its fixed-base percentage will be two-thirds of its ratio for its fifth through eighth years; and (5) for its tenth year, its fixed-base percentage will be five-sixths of its ratio for its fifth through ninth years. For subsequent taxable years, the taxpayer's fixed-base percentage will be its actual ratio of qualified research expenditures to gross receipts for five years selected by the taxpayer from its fifth through tenth taxable years.

The Revenue Reconciliation Act of 1993 extends the orphan drug tax credit for 30 months (for qualified clinical testing expenses incurred during the period July 1, 1992, through December 31, 1994)

Effective Date of New Federal Law

Applies to research expenditures paid or incurred during the period July 1, 1992, through June 30, 1995. The provision is effective for qualified clinical testing expenses (orphan drugs) incurred during the period July 1, 1992, through December 31, 1994.

Impact on California Revenue

Research Tax Credit
There is no revenue impact. California previously conformed to these provisions in SB 671.

Orphan Drug Tax Credit
Extending this credit is estimated to result in revenue losses of $1 million annually.

A-II-B: Training And Investment Incentives - Investment Incentives - Capital Gain Provisions

Public Law: 103-66

Act Section: 13113

Section Title: 50-Percent Exclusion for Gain From Certain Small Business Stock

Prior Federal Law (Sec. 1001)

Gain from the sale or exchange of stock held for more than one year generally is treated as long-term capital gain.

Net capital gain (i.e., long-term capital gain less short-term capital loss) of an individual is taxed at the same rates that apply to ordinary income, subject to a maximum rate of 28 percent.

Current California Law (Sec. 17062, 17063, 17276, 17736, 17750, 18152.5, 18683.5 and 19133.5)

In the 1993 Legislative Session, SB 671 substantially conformed California law to the provisions contained in the Revenue Reconciliation Act of 1993 with two exceptions designed to focus the California incentive on stock of corporations doing business primarily in California. Under the California modification, in order for the stock which is qualified small business stock for federal purposes to qualify as California qualified small business stock, the corporation must meet separate "active business" and "gross assets and California payroll" tests. That is, during substantially all of the taxpayer's holding period for the stock, at least 80% (by value) of the corporation's gross assets (including intangible assets) must be used by the corporation in the active conduct of a qualified trade or business in California. In order to satisfy the active business requirement, at least 80% of the corporation's payroll expense must be attributable to employment located within California. In addition, as of the date of issuance of the stock, at least 80% of the small business' payroll (measured by total dollar value) must be attributable to employment located within California.

Any gain that is excluded from gross income under Section 18152.5 is not taken into account in computing long-term capital gain or in applying the capital loss rules of Sections 1211 and 1212.

The amount treated as investment income for purposes of the investment interest limitation does not include any gain that is excluded from gross income under this provision.

One-half of any excluded gain under Section 18152.5 is treated as a preference for purposes of the alternative minimum tax.

An information report is required to be filed with the Franchise Tax Board by an eligible small business that issues qualified small business stock. Penalties are provided for failure to timely file the required reports

The provisions of SB 671 apply to qualified small business stock acquired from the qualified small business on or after August 10, 1993, and before January 1, 1999.

New Federal Law (Sec. 53, 57(a)(8)(new), 172(d), 642, 643, 691, 871, 1202(new) and 6652(k)(new))

The Revenue Reconciliation Act of 1993 generally permits a noncorporate taxpayer who holds qualified small business stock for more than 5 years to exclude 50 percent of any gain on the sale or exchange of the stock. The amount of gain eligible for the 50 percent exclusion is limited to the greater of (1) 10 times the taxpayer's basis in the stock or (2) $ 10 million gain from stock in that corporation. The $ 10 million limitation on eligible gain is applied on a shareholder-by-shareholder basis and for purposes of the 10-times-basis limitation, basis is determined by valuing any contributed property at fair market value (at the date of contribution).

Qualified small business stock

In order for stock held by a taxpayer to qualify as small business stock, the following requirements must be met.

Eligible stock and redemptions

The stock must be acquired by the taxpayer at the original issuance (directly or through an underwriter) in exchange for money, other property (not including stock) or as compensation for services provided to the issuing corporation (other than services performed as an underwriter of the stock).

In order to prevent evasion of the requirement that the stock be newly issued, the exclusion does not apply if the issuing corporation (1) purchases any stock from the stockholder (or a related person) within 2 years of the issuance of the stock or (2) redeems more than 5 percent (by value) of its own stock within 1 year of the issuance. For purposes of this anti-evasion rule, a corporation is treated as purchasing an amount of its stock equal to the amount of its stock treated as redeemed under Section 304(a) of the Internal Revenue Code.

Qualified corporation

The issuing corporation must be a qualified small business as of the date of issuance and during substantially all of the period that the taxpayer holds the stock.

A qualified small business is a "Subchapter C" corporation other than: a DISC or former DISC, a corporation with respect to which an election under Section 936 is in effect, a regulated investment company, a real estate investment trust, a real estate mortgage investment conduit, or a cooperative. The provision excludes from the definition of eligible corporation any corporation that has a direct or indirect subsidiary with respect to which an election under Section 936 of the Internal Revenue Code is in effect. The corporation also generally cannot own (i) real property the value of which exceeds 10 percent of its total assets or (ii) portfolio stock or securities the value of which exceeds 10 percent of its total assets in excess of liabilities.

Active business

During substantially all of the taxpayer's holding period for the stock, at least 80 percent (by value) of the corporation's gross assets (including intangible assets) must be used by the corporation in the active conduct of a qualified trade or business. If in connection with any future qualified trade or business, a corporation uses assets in certain start-up activities, research and experimental activities or in-house research activities, the corporation is treated as using such assets in the active conduct of a qualified trade or business. The active business requirement is met by a corporation with 80 percent of its assets used in the active conduct of one or more qualified trades or businesses.

Assets that are held to meet reasonable working capital needs of the corporation, or are held for investment and are reasonably expected to be used within 2 years to finance future research and experimentation, are treated as used in the active conduct of a trade or business. In addition, certain rights to computer software are treated as assets used in the active conduct of a trade or business.

A qualified trade or business is any trade or business other than one involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of the trade or business is the reputation or skill of 1 or more of its employees. The term also excludes any banking, insurance, leasing, financing, investing, or similar business, any farming business (including the business of raising or harvesting trees), any business involving the production or extraction of products of a character for which percentage depletion is allowable, or any business of operating a hotel, motel, restaurant or similar business.

A corporation that is a specialized small business investment company ("SSBIC") is treated as meeting the active business test. An SSBIC is defined as any corporation (other than certain non-qualified corporations) that is licensed by the Small Business Administration under Section 301(d) of the Small Business Act of 1958, as in effect on May 13, 1993.

Gross assets

As of the date of issuance of the stock, the excess of (1) the amount of cash and the aggregate adjusted bases of other property held by the corporation, over (2) the aggregate amount of indebtedness of the corporation that does not have an original maturity of more than one year (such as short-term payables), cannot exceed $50 million. For this purpose, amounts received in the issuance are taken into account. The $50 million size limitation is based on the issuer's gross assets (i.e., the sum of the cash and the adjusted bases of other property held by the corporation) without subtracting the short-term indebtedness of the corporation. For purposes of this rule, the adjusted basis of property contributed to the corporation is determined as if the basis of the property immediately after the contribution were equal to its fair market value. In addition to meeting the gross assets test, the corporation must agree to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.

If a corporation satisfies the gross assets test as of the date of issuance but subsequently exceeds the $50 million threshold, stock that otherwise constitutes qualified small business stock would not lose that characterization solely as a result of that subsequent event. If a corporation (or a predecessor corporation) exceeds the $50 million threshold at any time after December 31, 1992, the corporation cannot issue stock that would qualify for the exclusion.

<u>Subsidiaries of issuing corporation</u>

In the case of a corporation that owns at least 50 percent of the vote or value of a subsidiary, the parent corporation is deemed to own its ratable share of the subsidiary's assets for purposes of the "qualified corporation," "active business," and "gross assets" tests described above. Corporations that are part of a parent-subsidiary controlled group (using a more than 50% ownership test) are treated as a single corporation for purposes of the gross assets test.

<u>Pass-through entities</u>

Gain from the disposition of qualified small business stock by a partnership, S corporation, regulated investment company or common trust fund that is taken into account by a partner, shareholder or participant (other than a C corporation) is eligible for the exclusion, provided that (1) all eligibility requirements with respect to qualified small business stock are met, (2) the stock was held by the entity for more than 5 years, and (3) the partner, shareholder or participant held its interest in the entity on the date the entity acquired the stock and at all times thereafter and before the disposition of the stock. In addition, a partner, shareholder, or participant cannot exclude gain received from an entity to the extent that the partner's, shareholder's, or participant's share in the entity's gain exceeded the partner's, shareholder's or participant's interest in the entity at the time the entity acquired the stock.

Certain tax-free and other transfers

If qualified small business stock is transferred by gift or at death, the transferee is treated as having acquired the stock in the same manner as the transferor, and as having held the stock during any continuous period immediately preceding the transfer during which it was held by the transferor. A partner can treat stock distributed by a partnership as qualified small business stock as long as (1) all eligibility requirements with respect to qualified small business stock are met by the partnership with respect to its investment in the stock, and (2) the partner held its interest in the partnership on the date the partnership acquired the stock and at all times thereafter and before the disposition of the stock. In addition, a partner cannot treat stock distributed by a partnership as qualified small business stock to the extent that the partner's share of the stock distributed by the partnership exceeded the partner's interest in the partnership at the time the partnership acquired the stock.

Transferees in other cases are not eligible for the exclusion. Thus, for example, if qualified small business stock is transferred to a partnership and the partnership disposes of the stock, any gain from the disposition will not be eligible for the exclusion.

In the case of certain incorporations and reorganizations where qualified small business stock is transferred for other stock, the transferor treats the stock received as qualified small business stock. The holding period of the original stock is added to that of the stock received. However, the amount of gain eligible for the exclusion is limited to the gain accrued as of the date of the incorporation or reorganization. This limitation does not apply in the case where the stock received in the incorporation or reorganization was itself qualified small business stock.

Special basis rules

If property (other than money or stock) is transferred to a corporation in exchange for its stock, the basis of the stock received is treated as not less than the fair market value of the property exchanged. Thus, only gains that accrue after the transfer are eligible for the exclusion.

Options, nonvested stock, and convertible instruments

Stock acquired by the taxpayer through the exercise of options or warrants, or through the conversion of convertible debt, is treated as acquired at original issue. The determination whether the gross assets test is met is made at the time of exercise or conversion, and the holding period of such stock is treated as beginning at that time.

In the case of convertible preferred stock, the gross assets determination is made at the time the convertible stock is issued, and the holding period of the convertible stock is added to that of the common stock acquired upon conversion.

Stock received in connection with the performance of services is treated as issued by the corporation and acquired by the taxpayer when included in the taxpayer's gross income in accordance with the rules of Section 83.

Offsetting short positions

A taxpayer cannot exclude gain from the sale of qualified small business stock if the taxpayer (or a related person) held an offsetting short position with respect to that stock anytime before the 5-year holding period is satisfied. If the taxpayer (or a related person) acquires an offsetting short position with respect to qualified small business stock after the 5-year holding period is satisfied, the taxpayer must elect to treat the acquisition of the offsetting short position as a sale of the qualified small business stock in order to exclude any gain from that stock.

An offsetting short position is defined to be (1) a short sale of property substantially identical to the qualified small business stock (including writing a call option that the holder is more likely than not to exercise or selling the stock for future delivery) or (2) an option to sell substantially identical property at a fixed price.

Capital gains and investment interest

Any gain that is excluded from gross income under the bill is not taken into account in computing long-term capital gain or in applying the capital loss rules of Sections 1211 and 1212. In addition, the taxable portion of the gain is taxed under Section 1(h), which provides for a maximum rate of 28 percent.

The amount treated as investment income for purposes of the investment interest limitation does not include any gain that is excluded from gross income under this provision.

Minimum tax

One-half of any excluded gain is treated as a preference for purposes of the alternative minimum tax.

Effective Date of New Federal Law

Applies to stock issued after August 10, 1993.

Impact on California Revenue

No revenue impact. California responded to this provision in SB 671.

A-II-B: Training And Investment Incentives - Investment Incentives - Capital Gain Provisions

Public Law: 103-66

Act Section: 13114

Section Title: Rollover of Gain from Sale of Publicly Traded Securities Into Specialized Small Business Investment Companies

Prior Federal Law (Sec. 1016(a), 1031 and 1033)

In general, gain or loss is recognized on any sale, exchange or other disposition of property. The Internal Revenue Code contains provisions under which taxpayers may elect not to recognize gain realized on certain "like-kind" exchanges (Sec. 1031), or for certain involuntary conversions (Sec. 1033)

Current California Law (Sec. 18031, 18036, 24916, 24916.2 and 24917)

California is conformed to the nonrecognition of gain treatment for "like-kind" exchanges and, in general, for certain involuntary conversions.

New Federal Law (Sec. 1016 and 1044(new))

The Revenue Reconciliation Act of 1993 permits any corporation or individual to elect to roll over without payment of tax any capital gain realized upon the sale of publicly-traded securities where the corporation or individual uses the proceeds from the sale to purchase common stock or a partnership interest in a specialized small business investment company ("SSBIC") within 60 days of the sale of the securities. To the extent the proceeds from the sale of the publicly-traded securities exceed the cost of the SSBIC common stock or partnership interest, gain will be recognized currently. The taxpayer's basis in the SSBIC common stock or partnership interest is reduced by the amount of any gain not recognized on the sale of the securities.

Estates, trusts, S-corporations, and partnerships are not eligible to make this election to roll over gains. In addition, "publicly-traded securities" are defined as stock or debt traded on an established securities market. An SSBIC is defined as any partnership or corporation that is licensed by the Small Business Administration under Section 301(d) of the Small Business Investment Act of 1958, as in effect on May 13, 1993.

The amount of gain that an individual may elect to roll over under this provision for a taxable year is limited to the lesser of (1) $50,000 or (2) $500,000 reduced by the gain previously excluded under this provision. For corporations, these limits are $250,000 and $1,000,000.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Effective Date of New Federal Law

Applies to sales of publicly-traded securities on or after August 10, 1993.

Impact on California Revenue

The revenue loss for 1994-5 is estimated to be $1 million, based on federal projections.

A-II-C: Training And Investment Incentives - Investment Incentives - Modification to Minimum Tax Depreciation Rules

Public Law: 103-66

Act Section: 13115

Section Title: Modification to Minimum Tax Depreciation Rules

Prior Federal Law (Sec. 56(a), 56(g), and 168(b))

A taxpayer is subject to an alternative minimum tax (AMT) to the extent that the taxpayer's tentative minimum tax exceeds the taxpayer's regular income tax liability. A taxpayer's tentative minimum tax generally equals 20 percent (24 percent in the case of an individual) of the taxpayer's alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income (AMTI) is the taxpayer's taxable income increased by certain tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the deferral of income resulting from the regular tax treatment of those items.

One of the adjustments which is made to taxable income to arrive at AMTI relates to depreciation. For AMT purposes, depreciation on most personal property to which the modified Accelerated Cost Recovery System (MACRS) adopted in 1986 applies is calculated using the 150-percent declining balance method (switching to straight line in the year necessary to maximize the deduction) over the property's class life. The class lives of MACRS property generally are longer than the recovery periods allowed for regular tax purposes.

For taxable years beginning after 1989, the AMTI of a corporation is increased by an amount equal to 75 percent of the amount by which adjusted current earnings (ACE) of the corporation exceed AMTI (as determined before this adjustment). In general, ACE is AMTI with additional adjustments that generally follow the rules presently applicable to corporations in computing their earnings and profits. For purposes of ACE, depreciation is computed using the straight-line method over the class life of the property. Thus, a corporation generally must make two depreciation calculations for purposes of the AMT -- once using the 150-percent declining balance method over the class life and again using the straight-line method over the class life. Taxpayers may elect to use either method for regular tax purposes. If a taxpayer uses the straight-line method for regular tax purposes, it must also use the straight-line method for AMT purposes.

Current California Law (Sec. 17062, 17201, 23456, and 23802)

Individuals. The Personal Income Tax Law is conformed to federal rules with respect to the amount allowable in computing alternative minimum taxable income. An adjustment is required to be made for the difference between the amount allowed as depreciation for regular tax and the amount allowed as depreciation for AMT purposes. Although the federal rules apply for determining the amount allowable for AMT purposes, the amount of the actual adjustment may be different, due to differences (prior to January 1, 1987) in state and federal rules for computing depreciation for regular tax purposes.

Banks and Corporations. The Bank and Corporation Tax Law is conformed to federal rules with respect to the amount allowable in computing alternative minimum taxable income. An adjustment is required to be made for the difference between the amount allowed as depreciation for regular tax and the amount allowed as depreciation for AMT purposes. Although the federal rules apply for determining the amount allowable for AMT purposes, the amount of the actual adjustment may be different due to differences (past and present) in state and federal rules for computing depreciation for regular tax purposes.

Depreciation for "Adjusted Current Earnings." The Bank and Corporation Tax Law is conformed, with certain modifications, to federal rules for computing depreciation for purposes of making the "Adjusted Current Earnings" adjustment.

1. Property placed in service on or after January 1, 1990.

The amount allowed as a state deduction in computing "Adjusted Current Earnings" is computed under IRC Section 168(g) which, in general, requires use of the straight-line depreciation method over the recovery period applicable to that property. Although the federal rules apply for determining the amount of depreciation allowed, the amount of the actual adjustment may be different due to differences in state and federal rules for computing depreciation for regular tax purposes.

2. Property placed in service on or after January 1, 1987, and prior to January 1, 1990.

The amount allowed as a state deduction in computing "Adjusted Current Earnings" is the amount that would have been allowed if the taxpayer depreciated the remaining adjusted basis of the property (under AMT rules), as of January 1, 1990, using the straight-line method over the remainder of the recovery period applicable to that property under the alternative system of Section 168(g) of the Internal Revenue Code. Although the federal rules apply for determining the amount of depreciation allowed, the amount of the actual adjustment may be different due to differences in state and federal rules for computing depreciation for regular tax purposes.

3. Property placed in service on or after January 1, 1981, and before January 1, 1987.

Except for Section 24349.5 Property (residential rental property for which construction commenced between 6/30/85 and 7/1/88), the amount allowable for computing "adjusted current earnings" is the amount that would have been allowed if the taxpayer depreciated the property under the straight-line method for each year of the "useful life" of the property.

With respect to Section 24349.5 Property, the amount allowable for computing "adjusted current earnings" is the amount that would have been allowed if the taxpayer depreciated the remaining adjusted basis of the property (under AMT rules), as of January 1, 1990, using the straight-line method over the remainder of the recovery period applicable to that property under the alternative system of Section 168(g) of the Internal Revenue Code. The state follows federal rules for this property, however, the amount of the actual adjustment may be different due to differences in state and federal recovery periods for computing depreciation for regular tax purposes.

4. Property placed in service prior to January 1, 1981.
The amount allowed as a state deduction in computing "Adjusted Current Earnings" is the same amount that was computed for state regular tax purposes (same as federal rule).

New Federal Law (Sec. 56)

The Revenue Reconciliation Act of 1993 eliminates the depreciation component of the ACE adjustment. Thus, corporations will compute AMT depreciation by using the rules generally applicable to individuals (i.e., the 150-percent declining balance method over the class life of the property for tangible personal property.)

Effective Date of New Federal Law

The provision is effective for property placed in service after December 31, 1993.

Impact on California Revenue

The revenue loss for the first full year would be in the $10 million range under the Bank & Corporation Tax Law.

A-II-D: Training And Investment Incentives - Investment Incentives - Increase In Expense Treatment for Small Business

Public Law: 103-66

Act Section: 13116

Section Title: Increase In Expense Treatment For Small Business

Prior Federal Law (Sec. 179(b))

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $10,000 of the cost of qualifying property placed in service for the taxable year. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $10,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations)

Current California Law (Sec. 17201, 17252.5, 17255, 17265, 17266, 23802, 24356, 24356.2, 24356.3, 24356.4, and 24356.5)

Individuals and "S" Corporations. California is fully conformed to IRC Sec. 179, relating to the expensing of depreciable business property.

Banks and Corporations. Since California depreciation for banks and corporations is still computed under the old federal ADR system (having not conformed to the ACRS and MACRS systems), California does NOT conform to IRC Sec. 179, relating to the expensing of depreciable business property. Instead, California continues to allow additional first year depreciation of up to $2,000, which was an element of the old federal ADR system.

All Taxpayers. California has conformed to IRC Sec. 179A, relating to the deduction for clean-fuel vehicles and refueling property.

In addition, California has adopted special rules for the expensing of qualified business property in Enterprise Zones (up to $10,000 depending upon the year in which the Zone was designated), Program Areas (up to $40,000 depending upon the year in which the Area was designated), and the Los Angeles Revitalization Zone (unlimited) and the Local Agency Military Base Recovery Area (up to $10,000 depending upon the year in which the Area was designated). These special state rules are more generous than federal law in that they do not contain limitations similar to those contained in IRC Section 179 that limit deductions to the amount of income from the trade or business and which reduce or eliminate the deduction when total investments in business assets exceed $200,000 for the taxable year.

New Federal Law (Sec. 179)

The Revenue Reconciliation Act of 1993 increases the $10,000 amount allowed to be expensed under Section 179 to $17,500 for property placed in service in taxable years beginning after December 31, 1992.

Effective Date of New Federal Law

Applies to property placed in service in taxable years beginning after December 31, 1992.

Impact on California Revenue

The increase in expense deductions under the Personal Income Tax Law would result in a $30 million cash flow revenue loss for the first fiscal year, decreasing thereafter due to smaller depreciation deductions for the same assets.

A-II-E: Training And Investment Incentives - Investment Incentives - Tax Exempt Bonds

Public Law: 103-66

Act Section: 13121

Section Title: High-speed Intercity Rail Facility Bonds Exempt from State Volume Cap

Prior Federal Law (Sec. 146)

High-speed intercity rail facilities qualify for tax-exempt bond financing if trains operating on the facility are reasonably expected to carry passengers and their baggage at average speeds in excess of 150 miles per hour between stations. Such facilities need not be governmentally-owned but the owner must irrevocably elect not to claim depreciation or any tax credit with respect to bond-financed property.

Twenty-five percent of each bond issue for high-speed intercity rail facilities must receive an allocation from a State private activity bond volume limitation. If facilities are located in two or more States, this requirement must be met on a State-by-State basis for the financing of facilities located in each State.

Current California Law (Sec. 17133, 17143 and 24272)

California specifically does not conform to the federal rules relating to the qualification of private activity bonds for tax-exempt status.

Instead, for purposes of the Personal Income Tax Law and the Corporate Income Tax (Chapter 3 of Part 11), California law provides that income which this state is prohibited from taxing includes interest on bonds issued by this state or a local government in this state, and the determination of whether a bond is issued by this state or a local government in this state shall be made without regard to (a) the source of payment of that bond or the security for that bond, public or private, and (b) whether or not public improvements are financed. However, for franchise tax purposes, all interest from state and local obligations is included in net income which is used to measure the tax to be paid for the privilege of conducting business in California for the next year.

New Federal Law (Sec. 146)

The requirement that 25 percent of each high-speed rail facility bond issue receive an allocation from a State private activity-bond volume limitation is repealed only if all the bond-financed property is governmentally owned. (Bonds issued for privately-owned property would remain subject to the current-law rules with respect to the 25-percent volume cap allocation requirement.)

Effective Date of New Federal Law

Applies to bonds issued after December 31, 1993.

Impact on California Revenue

Not applicable, since California has not conformed to prior law.

A-II-E: Training And Investment Incentives - Investment Incentives - Tax Exempt Bonds

Public Law: 103-66

Act Section: 13122

Section Title: Permanent Extension of Qualified Small Issue Bonds

Prior Federal Law (Sec. 144)

Interest on certain small issues of private activity bonds is excluded from income if at least 95 percent of the bond proceeds is used to finance: (1) manufacturing facilities or (2) agricultural land or property for first-time farmers ("qualified small-issue bonds"). Qualified small-issue bonds are those for which (i) the aggregate authorized face amount of the issue is $1 million or less, or (ii) the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, does not exceed $10 million. Special limits apply to these bonds for first-time farmers. As private activity bonds, qualified small-issue are subject to the volume cap. Treasury Department regulation 1.103-8(a)(5) generally requires that qualified small-issue bonds be issued within one year after the property being financed is placed in service.

Authority to issue qualified small-issue bonds expired after June 30, 1992.

Current California Law (Sec. 17133, 17143 and 24272)

California specifically does not conform to the federal rules relating to the qualification of private activity bonds for tax-exempt status.

Instead, for purposes of the Personal Income Tax Law and the Corporate Income Tax (Chapter 3 of Part 11), California law provides that income which this state is prohibited from taxing includes interest on bonds issued by this state or a local government in this state, and the determination of whether a bond is issued by this state or a local government in this state shall be made without regard to (a) the source of payment of that bond or the security for that bond, public or private, and (b) whether or not public improvements are financed. However, for franchise tax purposes, all interest from state and local obligations is included in net income which is used to measure the tax to be paid for the privilege of conducting business in California for the next year.

New Federal Law (Sec. 144)

The Revenue Reconciliation Act of 1993 permanently extends the authority to issue qualified small-issue bonds. In addition, it provides that the one-year placed-in-service period does not expire before January 1, 1994 for property with respect to which this one year period, under Treasury Regulation 1.103-8(a)(5) or any successor regulation otherwise would expire after June 30, 1992, and before January 1, 1994. Because these bonds must be issued no later than December 31, 1993 and because carryforwards of qualified small-issue bonds are not allowed under the State private activity bond volume limitation rules, the applicable State volume limitation from which an allocation is required is that for calendar year 1993.

Effective Date of New Federal Law

The extension is effective for bonds issued after June 30, 1992. The provision relating to Treasury regulation 1.103-8(a)(5) is effective on August 10, 1993.

Impact on California Revenue

Not applicable, since California has not conformed to prior federal law.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

A-III: Training And Investment Incentives - Expansion And Simplification of Earned Income Tax Credit

Public Law: 103-66

Act Section: 13131

Section Title: Expansion and Simplification of Earned Income Tax Credit

Prior Federal Law (Sec. 32, 162, 213 and 3507)

Eligible low-income workers with one child can claim a refundable earned income tax credit (EITC) of up to 18.5 percent of the first $7,750 of earned income for 1993 (19.5 percent for taxpayers with more than one qualifying child). The maximum amount of credit for 1993 is $1,434 ($1,511 for taxpayers with more than one qualifying child).

This maximum credit is reduced by 13.21 percent of earned income (or adjusted gross income, if greater) in excess of $12,200 (13.93 percent for taxpayers with more than one qualifying child). In 1993, the EITC is totally phased out for workers with earned income (or adjusted gross income, if greater) over $23,050. The maximum amount of earned income on which the EITC may be claimed, and the income threshold for the phaseout of the EITC, are indexed for inflation. Earned income consists of wages, salaries, other employee compensation, and net self-employment income.

Prior law provided that the credit rates for the EITC were to increase in 1994, as shown in the following table.

	One qualifying child --		Two or more qualifying children --	
Year	Credit rate	Phaseout rate	Credit rate	Phaseout rate
1993	18.5	13.21	19.5	13.93
1994 and after	23.0	16.43	25.0	17.86

A worker may elect to receive the EITC on an advance basis by furnishing a certificate of eligibility to his or her employer. For such a worker, the employer makes an advance payment of the credit at the time wages are paid.

A supplemental young child credit is available to taxpayers with qualifying children under the age of one year. This young child credit rate is 5 percent and the phase-out rate is 3.57 percent. It is computed on the same income base as the ordinary EITC. The maximum supplemental young child credit for 1993 is $388.

A supplemental health insurance credit is available to taxpayers who provide health insurance coverage for their qualifying children. This health insurance credit rate is 6 percent and the phase-out rate is 4.285 percent. It is computed on the same income base as the ordinary EITC, but the credit claimed cannot exceed the out-of-pocket cost of the health insurance coverage. In addition, the taxpayer is denied an itemized deduction for medical expenses of qualifying insurance coverage up to the amount of credit claimed. The maximum supplemental health insurance credit for 1993 is $465.

Current California Law (Sec. None)

California has never enacted an earned income tax credit.

New Federal Law (Sec. 32, 162, 213 and 3507)

The supplemental young child credit and the supplemental health insurance credit are repealed.

For taxpayers with one qualifying child, the EITC is 26.3 percent of the first $7,750 of earned income in 1994. The maximum credit in 1994 is $2,038 and is reduced by 15.98 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. For 1995 and thereafter, the credit rate increases to 34.0 percent but the earned income to be multiplied by the rate is reduced to $6,000 (adjusted for inflation). The phaseout rate for 1995 and thereafter remains at 15.98 percent of earned income (or adjusted gross income, if greater) in excess of $11,000 (adjusted for inflation).

For taxpayers with two or more qualifying children, the EITC is 30.0 percent of the first $8,425 of earned income in 1994. The maximum credit for 1994 is $2,527 and is reduced by 17.68 percent of earned income (or adjusted gross income, if greater) in excess of $11,000. The credit rate increases over time and equals 36.0 percent for 1995 and 40.0 percent for 1996 and thereafter. The phase-out rate for 1995 is 20.22 percent (21.06 percent for 1996 and thereafter) of earned income (or adjusted gross income, if greater) in excess of $11,000 (adjusted for inflation).

Starting in 1994, the EITC is extended to taxpayers with no qualifying children who are over age 25 and below age 65. For taxpayers with no qualifying children, the EITC is 7.65 percent of the first $4,000 of earned income. The maximum credit for 1994 is $306 and is reduced by 7.65 percent of earned income (or adjusted gross income, if greater) in excess of $5,000. The only change for 1995 and later years is that the amount of earned income is adjusted for inflation.

Effective Date of New Federal Law

Applies to taxable years beginning after December 31, 1993.

Impact on California Revenue

Not applicable since California has not conformed to prior federal law.

A-IV-A: Training And Investment Incentives - Incentives For Investment In Real Estate - Extension Of Qualified Mortgage Bonds And Low-Income Housing Credit

Public Law: 103-66

Act Section: 13141

Section Title: Permanent Extension of Qualified Mortgage Bonds

Prior Federal Law (Sec. 25 and 143)

Qualified mortgage bonds ("QMBs") are bonds the proceeds of which are used to finance the purchase, or qualifying rehabilitation or improvement, of single-family, owner-occupied residences located within the jurisdiction of the issuer of the bonds (Sec. 143). Persons receiving QMB loans must satisfy a home purchase price, borrower income, first-time homebuyer, and other requirements. Part or all of the interest subsidy provided by QMBs is recaptured if the borrower experiences substantial increases in income and disposes of the subsidized residence within nine years after purchase.

Tax Credit - Mortgage credit certificates

Qualified governmental units may elect to exchange QMB authority for authority to issue mortgage credit certificates ("MCCs") (Sec. 25). MCCs entitle homebuyers to nonrefundable income tax credits for a specified percentage of interest paid on mortgage loans on their principal residences. Once issued, an MCC remains in effect as long as the loan remains outstanding and the residence being financed continues to be the certificate recipient's principal residence. MCCs are subject to the same targeting requirements as QMBs.

Expiration

Authority to issue QMBs and to elect to trade in bond volume authority to issue MCCs expired after June 30, 1992.

Current California Law (Sec. None)

California has never enacted a tax credit for mortgage interest paid on mortgage loans on a principal residence.

New Federal Law (Sec. 25 and 143)

Permanently extends the authority to issue QMBs and to elect to trade in QMB authority for authority to issue MCCs.

Treatment of certain housing affordability programs

Provides that, in high housing cost areas, the fact that an issuer of QMBs or MCCs also provides certain mortgage loans or grants other than first mortgage loans or grants to homebuyers in conjunction with QMB or

MCC financing will not preclude availability of the QMB- or MCC-assistance on the purchase of a residence. Qualifying subordinate mortgage loans or grants may not be financed directly or indirectly with tax-exempt private activity bonds. Also qualifying subordinate mortgage loans or grants either must be accompanied by a "resale price control restriction", (or in the case of loans must be, "shared appreciation loans"). Finally, the local government must retain its interest in the home's appreciation for a period at least as long as the Federal QMB and MCC recapture period. A resale price control restriction is defined as a deed restriction, right of repurchase, or similar mechanism which (1) requires the owner to sell the unit to a purchaser qualifying for QMB or MCC financing and (2) limits the resale price to an amount not exceeding the initial purchase price plus an indexed amount that is less than the full appreciation on the residence. A shared appreciation loan is defined as a below-market rate or deferred interest loan which entitles the governmental lender to a share of any appreciation in value (attributable to the portion of the residence financed with the shared appreciation loan) realized upon disposition of the residence as repayment for the subsidy provided by the loan.

Any interest of a governmental unit in a QMB- or MCC-financed residence attributable to a qualifying subordinated mortgage loan will be disregarded for purposes of (1) the first-time homebuyer and owner-occupied residence requirements of the QMB and MCC programs; (2) the maximum purchase price limit for QMB-and MCC-financed residences; (3) the rules for determining who is the owner of a QMB- or MCC-financed residence; and (4) the rules for determining the effective rate of interest on QMB-financed loans. The terms of the subordinated mortgage loan or grant will be taken into account, however, for measuring the amount of the homeowner's gain, if any, under the QMB- and MCC-recapture restrictions. The special rules for these housing affordability programs will not apply to any subordination loans or grant if the governmental unit's interest under the loan or grant is structured so as to realize an amount in excess of the pro rata portion of the appreciation on the residence financed with the subordinated mortgage loan or grant (e.g., by allocating to the governmental unit an amount of gain on disposition greater than the proportionate amount of the total subsidy to the homebuyer that is provided by the subordinated mortgage loan).

Treatment of certain contracts for deeds

In the case of certain homebuyers whose family incomes do not exceed fifty percent of applicable median family income, ownership of land subject to certain contracts for deed does not violate the requirement that QMB- and MCC-financed homebuyers be first-time homebuyers and that the financing provided be for new mortgages. Thus, QMB-financed loans may be made (and MCCs to be granted) to individuals who own and maintain their principal residence on land subject to these contracts for deed provided that the homebuyers satisfy (a) all otherwise applicable requirements of the QMB and MCC programs but for the contract for deed and (b) the special income limit. These loans may be used to repay the contract for deed and to finance a new residence on the land. Also, as under present law, these homebuyers will remain eligible for qualified home improvement loans to rehabilitate existing principal residences on the land held subject to the contracts for deed.

Treatment of certain two-family housing

A present-law exception to the requirement that all residences receiving qualified mortgage bond financing or MCCs be single family, owner-occupied housing is expanded to allow certain newly constructed two-family housing to qualify. Under the expanded exception, newly constructed two-family housing will be eligible for these subsidies if (a) the housing is located in a targeted area of economic distress (Sec. 143(j)), (b) at least one of the two units is occupied as the principal residence of the mortgagor, and (c) the family income of the mortgagor is 140 percent or less of the applicable area median family income.

Effective Date of New Federal Law

The extension of the QMB and MCC programs is effective after June 30, 1992. The three modifications are effective for QMB and MCC- financing provided after August 10, 1993.

Impact on California Revenue

Not applicable, since California has not conformed to prior federal law.

A-IV-A: Training And Investment Incentives - Incentives For Investment In Real Estate - Extension Of Qualified Mortgage Bonds And Low-Income Housing Credit

Public Law: 103-66

Act Section: 13142

Section Title: Low-Income Housing Credit

Prior Federal Law (Sec. 42(i) and 42(o))

In general

A tax credit is allowed in annual installments over 10 years for qualifying newly constructed or substantially rehabilitated low-income residential rental housing. For most qualifying housing, the credit has a present value of 70 percent of the qualified basis of the low-income housing units. For housing also receiving other Federal subsidies (e.g., tax-exempt bond financing) and for the acquisition cost (e.g., costs other than rehabilitation expenditures) of existing housing that is substantially rehabilitated, the credit has a present value of 30 percent of qualified costs.

HOME funds

Housing which receives assistance under the National Affordable Housing Act of 1990 generally is treated as Federally subsidized and therefore not eligible for the 70 percent present value credit.

Full-time students

A housing unit generally is not eligible for the low-income housing tax credit if the tenants are full-time students who are not married individuals filing joint returns. Exceptions to this rule allow the credit to be claimed on housing units occupied by persons who are enrolled in certain job training programs or by students who are receiving Aid to Families with Dependent Children (AFDC) payments.

Deep-rent skewing

Generally, the credit amount is based on the qualified basis of the housing units serving low-income tenants. A residential rental project will qualify for the credit only if (1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 50 percent of area median income, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 60 percent of area median income. A different income targeting rule applies to entities described in Sec. 142(d)(6) of the Code. These income figures are adjusted for family size. The low income set-aside is elected when the project is placed in service.

To qualify under the deep rent skewing exception from the general targeting requirements, 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 200 percent of rents charged on comparable rent restricted units. For projects receiving allocations prior to 1990, rents on market rate units must be at least 300 percent of rents charged on comparable rent restricted units.

Maximum rent

The maximum rent that may be charged a family in a low-income housing tax credit unit depends on the number of bedrooms in that unit. Prior to 1990, maximum allowable rent was determined on the basis of the actual family size of the occupants.

Tenant occupancy

Under the general low-income tenant occupancy requirement, a residential rental project qualifies for the low-income housing tax credit only if at least:

(1) 20 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 50 percent of area median income or,

(2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals whose incomes do not exceed 60 percent of area median income.

Income recertification

Generally, the owner of a low-income housing project must annually recertify tenant incomes to meet the low-income tenant occupancy requirements, regardless of whether the building is entirely occupied by low-income tenants.

Tenant protection

The low-income housing tax credit provisions in the Code do not include any specific provisions concerning the grounds for denial of admission to low-income housing projects, for termination of a tenancy, or for refusal to renew the lease of a tenant.

Developmental and operational costs

In general, housing credit agencies cannot allocate more low-income housing tax credits to a project than are necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the 10-year credit period. In making this determination, a housing credit agency must consider (1) the sources and uses of funds and the total financing of the project, (2) any proceeds expected to be generated by reason of tax benefits and (3) the percentage of the housing credit dollar amount to be used for project costs other than the costs of intermediaries.

Allocation between buyer and seller in month of disposition

The Code requires that the low-income housing tax credit be divided between a buyer and seller of a low-income housing tax credit project based upon the number of days during the year of disposition that the project was held by each. The Internal Revenue Service has issued guidance that requires a mid-month averaging convention.

Expiration

The low-income housing tax credit expired after June 30, 1992.

<u>Current California Law (Sec. 17058 and 23610.5)</u>

California allows a 30% credit for costs paid or incurred for the purchase of, or improvements to, low-income housing if a project meets the federal rules, subject to the following state modifications:

- o The project must be located in California and must either:

  1) have been allocated a credit for federal income tax purposes, or

  2) qualify for the federal credit rules that provide that 70% or more of the building is financed with exempt bonds subject to a specified volume limit.

- o The California credit is claimed over 4 years rather than 10 years as required under federal law.

- o The project qualifies for the California applicable percentages for buildings placed in service after 1987. The applicable percentage means either:

  1) for each of the first three years, the highest percentage set under the federal rules for the month the project is placed in service, and

  2) for the fourth year, the difference between 30% and the sum of the applicable percentages for the first three years.

- o All elections made by a taxpayer pursuant to the federal low-income housing credit apply for state purposes.

- o The credit is authorized by the California Tax Credit Allocation Committee to the taxpayer based on the project's need for the credit in order to make the project economically feasible.

- The aggregate credit that may be allocated annually is limited to the sum of $35 million, the prior year unused housing credit ceiling, and the amount of housing credit previously allocated and then returned in the calendar year from projects that did not become qualified low-income housing projects within the specified period of time.

The California low-income housing credit is available as long as Section 42 of the Internal Revenue Code remains in effect.

New Federal Law (Sec. 42)

Extension

The Revenue Reconciliation Act of 1993 permanently extends the low-income housing tax credit.

HOME funds

The Revenue Reconciliation Act of 1993 provides that a building shall not be treated as Federally subsidized solely by reason of assistance with respect to that building received under the National Affordable Housing Act of 1990 (as in effect on the date of enactment of this provision) if 40 percent or more of the aggregate residential rental units in the residential rental project receiving the assistance are occupied by individuals with 50 percent or less of area median income. With respect to entities described in Section 142(d)(6), the 40 percent or more requirement is reduced to 25 percent or more, consistent with the income targeting rules currently applicable to those entities. These projects are eligible for the 70 percent and 30 percent credits but not for the 91-percent or 39 percent credits otherwise available in qualified census tracts and difficult development areas.

Full-time students

The Revenue Reconciliation Act of 1993 provides that a housing unit occupied entirely by full-time students may qualify for the credit if the full-time students are a single parent and his or her minor children and none of the tenants is a dependent of a third party. The Revenue Reconciliation Act of 1993 also codifies the present-law exception regarding married students filing joint returns (which continues to apply to all buildings placed in service since original enactment of the low-income housing tax credit by the Tax Reform Act of 1986).

Deep-rent skewing

The Revenue Reconciliation Act of 1993 allows an irrevocable election by the owner of a low-income building receiving a credit allocation before 1990 to satisfy the 200-percent rent restriction rather than the 300-percent rent restriction. The election is available only to taxpayers who enter into a compliance monitoring agreement with a housing credit agency. Further, the election applies only with respect to tenants first occupying any unit in the building after the date of the election, and must be made within 180 days after the date of enactment. The irrevocable election does not allow rent increases on existing low-income tenants.

Maximum rent

The Revenue Reconciliation Act of 1993 allows an irrevocable election by the owner of a low-income building placed in-service before 1990 to use either apartment size or family size in determining maximum allowable rent. The election is available only to taxpayers who enter into a compliance monitoring agreement with a housing credit agency. Further, the election applies only with respect to tenants first occupying any unit in the building after the date of the election, and must be made within 180 days after the date of enactment.

Tenant Occupancy

The Revenue Reconciliation Act of 1993 authorizes the Treasury Department to provide a waiver of penalties for de minimis errors in the application of the low-income tenant occupancy requirement.

Income recertification

The Revenue Reconciliation Act of 1993 authorizes the Treasury Department to grant a waiver from the annual recertification of tenant income for tenants in buildings that are occupied entirely by low-income tenants. Third-party verification of a tenant's or prospect tenant's income from his combined assets is not necessary if (1) the combined assets do not exceed $5,000 and (2) the tenant or prospective tenant provides a signed, sworn statement to this effect to the building owner. The Conference Report contains a statement that the conferees do not intend to modify the treatment of individuals receiving Section 8 assistance.

Tenant protection

The Revenue Reconciliation Act of 1993 provides that an applicant may not be denied admission to a low-income housing tax credit project because the applicant holds a voucher or certificate of eligibility under Section 8 of the Housing Act of 1937.

Developmental and operational costs

The Revenue Reconciliation Act of 1993 requires a housing credit agency to consider the reasonableness of the developmental and operational costs of a project as an additional factor in making its determination as to the proper amount of low-income housing tax credits to allocate to a project. The Conference Report contains a statement that the provision is not intended to create a national standard of reasonableness. The conferees intend for allocating agencies to set standards of reasonableness reflecting the applicable facts and circumstances including the location of the projects and the uses for which the projects are built.

Allocation between buyer and seller in month of disposition

The Revenue Reconciliation Act of 1993 provides that the buyer and seller may agree to use either the exact number of days or the mid-month convention to determine the division of the credit in the month of disposition.

Effective Date of New Federal Law

The extension of the low-income housing tax credit and the provision relating to: (1) full-time students, and (2) developmental and operational cost are effective after June 30, 1992.

The provisions relating to: (1) tenant occupancy, (2) income recertification, (3) tenant protection, (4) allocations between the buyer and seller, and (5) HOME funds are effective on August 10, 1993. The elections relating to maximum rent and deep-rent skewing must be made within 180 days after August 10, 1993.

Impact on California Revenue

This provision is automatically extended under current state law. The baseline revenue loss is estimated to be $35 million for 1994-5.

A-IV-B: Training And Investment Incentives - Incentives For Investment In Real Estate - Passive Loss Rules

Public Law: 103-66

Act Section: 13143

Section Title: Application of Passive Loss Rules to Rental Real Estate Activities

Prior Federal Law (Sec. 469)

The passive loss rules limit deductions and credits from passive trade or business activities. Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. A similar rule applies to credits. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person.

The passive loss rules apply to individuals, estates and trusts, closely held C corporations, and personal service corporations. A special rule permits closely held C corporations to apply passive activity losses and credits against active business income (or tax liability allocable thereto) but not against portfolio income.

Passive activities are defined to include trade or business activities in which the taxpayer does not materially participate. Rental activities (including rental real estate activities) are also treated as passive activities, regardless of the level of taxpayer's participation. A special rule permits the deduction of up to $25,000 of losses from rental real estate activities (even though they are considered passive), if the taxpayer actively participates in them. This $25,000 amount is allowed for taxpayers with adjusted gross incomes of $100,000 or less, and is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000.

Current California Law (Sec. 17551, 17561 and 24692)

California conforms to the federal passive activity rules. California also makes those rules applicable to "S" corporations for purposes of computing the corporation's corporate level tax.

New Federal Law (Sec. 469)

The Revenue Reconciliation Act of 1993 treats a taxpayer's rental real estate activities in which he materially participates as not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which the taxpayer performs services.

Real property trade or business means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

An individual taxpayer meets the eligibility requirements if (1) more than half of the personal services the taxpayer performs in trades or businesses during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and (2) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates. In the case of a joint return, the eligibility requirements are met only if either spouse separately satisfies the requirements. Thus, one of the spouses separately must satisfy the requirement with respect to half of such spouse's personal services and the requirement with respect to 750 hours of services, without regard to services performed by the other spouse. In determining material participation, however, there is no change to the present-law rule that the participation of the spouse of the taxpayer is taken into account.

Effective Date of New Federal Law

The provision is effective with respect to taxable years beginning after December 31, 1993.

Impact on California Revenue

The revenue loss for 1994-5 is estimated to be $20 million, primarily under the Personal Income Tax Law.

A-IV-C: Training And Investment Incentives - Incentives For Investment In Real Estate - Provisions Relating To Real Estate Investments By Pension Funds

Public Law: 103-66

Act Section: 13144

Section Title: Real Estate Property Acquired by a Qualified Organization

Prior Federal Law (Sec. 514(c))

In general, a qualified pension trust or an organization that is otherwise exempt from federal income tax is taxed on income from a trade or business that is unrelated to the organization's exempt purposes (unrelated business taxable income or "UBTI"). Certain types of income, including rents, royalties, dividends, and interest are excluded from UBTI, except when such income is derived from "debt-financed property."

An exception to the rule treating income from debt-financed property as UBTI is available to pension trusts, educational institutions, and certain other exempt organizations ("qualified organizations") that make debt-financed investments in real property.

The real property exception to the debt-financed property rules is available for investments in debt-financed property, only if the follow restrictions are satisfied:

1) The purchase price of the real property is a fixed amount determined as of the date of the acquisition ("fixed price restriction")

2) The amount of the indebtedness or any amount payable with respect to the indebtedness, or the time for making any payment of any such amount (in whole or in part) upon revenues, income, or profits derived from the property ("participating loan restriction")

3) The property is not leased by the qualified organization to the seller or to a person related to the seller ("leaseback restriction")

4) In the case of a pension trust, the seller or lessee of the property is not a disqualified person ("disqualified person restriction")

5) The seller or a person related to the seller (or a person related to the plan with respect to which a pension trust was formed) is not providing financing in connection with the acquisition of the property ("seller-financing restriction")

6) If the investment in the property is held through a partnership, certain additional requirements are satisfied by the partnership ("partnership restriction")

Current California Law (Sec. 23735)

California is conformed, by reference, to federal rules that apply with respect to the definition and treatment of a tax-exempt organization's debt-financed income.

New Federal Law (Sec. 514(c))

The following restrictions are being relaxed, as described:

- o The leaseback and disqualified person restrictions are relaxed to permit a limited leaseback of debt-financed real property to the seller (or a person related to the seller) or to a disqualified person in the case where (1) no more than 25 percent of the leasable floor space in the building (or complex of buildings) is leased back to the seller (or related party) and (2) the lease is on commercially reasonable terms, independent of the sale and other transactions.
- o The seller-financing restriction is relaxed to permit seller financing on terms that are commercially reasonable independent of the sale or other transactions.
- o The fixed price and participating loan restrictions for certain sales of real property foreclosed upon by financial institutions are relaxed in certain limited cases.

Effective Date of New Federal Law

Applies to acquisitions (or leases entered into) on or after January 1, 1994.

Impact on California Revenue

For all provisions dealing with pension investments in real estate (Act Sections 13144 through 13149), the revenue loss for 1994-5 would be on the order of $5 million based on federal projections.

A-IV-C: Training And Investment Incentives - Incentives For Investment In Real Estate - Provisions Relating To Real Estate Investments By Pension Funds

Public Law: 103-66

Act Section: 13145

Section Title: Repeal of Special Treatment of Publicly Treated Partnerships

Prior Federal Law (Sec. 512)

In general, the character of a partner's distributive share of partnership income is the same as if the income had been directly realized by the partner. Thus, whether a tax-exempt organization's share of income from a partnership (other than from a publicly-traded partnership) is treated as unrelated business income depends on the underlying character of the income (Sec. 512(c)(1)).

By contrast, a tax-exempt organization's distributive share of gross income from a publicly-traded partnership (that is not otherwise treated as a corporation) automatically is treated as gross income derived from an unrelated trade or business (Sec. 512(c)(2)(A)). The organization's share of the partnership deductions is allowed in computing the organization's UBTI (Sec. 512(c)(2)(B)).

Current California Law (Sec. 17651 and 23732)

California is conformed, by reference, to federal rules that apply with respect to the definition and treatment of a tax-exempt organization's unrelated business taxable income (UBIT).

New Federal Law (Sec. 512)

The Revenue Reconciliation Act of 1993 repeals the rule that automatically treats income from publicly-traded partnerships as UBTI. Thus, investments in publicly-traded partnerships are treated the same as investments in other partnerships for purposes of the UBTI rules.

Effective Date of New Federal Law

The provision is effective for partnership years beginning on or after January 1, 1994.

Impact on California Revenue

Combined with Act Section 13144.

A-IV-C: Training And Investment Incentives - Incentives For Investment In Real Estate - Provisions Relating To Real Estate Investments By Pension Funds

Public Law: 103-66

Act Section: 13146

Section Title: Title-holding Companies Permitted to Receive Small Amounts of Unrelated Business Taxable Income

Prior Federal Law (Sec. 501(c)(2) and 501(c)(25))

Section 501(c)(2) provides tax-exempt status to certain corporations organized for the exclusive purpose of holding title to property and remitting any income from the property to one or more related tax-exempt organizations. Section 501(c)(25) provides tax-exempt status to certain corporations and trusts that are organized for the exclusive purposes of acquiring and holding title to real property, collecting income from such property, and remitting the income to no more than 35 shareholders or beneficiaries that are: (1) qualified pension, profit-sharing, or stock bonus plans (Sec. 401(a)); (2) governmental pension plans (Sec. 414(d)); (3) the United States, a State or political subdivision, or governmental agencies or instrumentalities; or (4) tax-exempt charitable, educational, religious, or other organizations described in Section 501(c)(3). However, the IRS has taken the position that a title-holding company described in Section 501(c)(2) or 501(c)(25) will lose its tax-exempt status if it generates any amount of certain types of UBTI.

Current California Law (Sec. 23701h and 23701x)

The California exemption for a Section 501(c)(2) organization is contained in Section 23701h and in Section 23701x, California grants exemption to Section 501(c)(25) organizations. Thus, California is in conformity with federal law and would apply the IRS position taken in IRS Notice 88-121, 1988-2 C.B. 457, and in Treasury Regulation 1.501(c)(2)-1(a).

New Federal Law (Sec. 501(c)(2) and 501(c)(25))

The Revenue Reconciliation Act of 1993 permits a title-holding company that is exempt from tax under Sections 501(c)(2) or 501(c)(25) to receive UBTI (that would otherwise disqualify the company) up to 10 percent of its gross income for the taxable year, provided that the UBTI is incidentally derived from the holding of real property. For example, income generated from parking or operating vending machines located on real property owned by a title-holding company generally would qualify for the 10-percent de minimis rule, while income derived from an activity that is not incidental to the holding of real property (e.g., manufacturing) would not qualify. In cases where unrelated income is incidentally derived from the holding of real property, receipt by a title-holding company of such income (up to the 10-percent limit) will not jeopardize the title-holding company's tax-exempt status, but nonetheless, will be subject to tax as UBTI.

In addition, it provides that a Section 501(c)(2) or 501(c)(25) title-holding company will not lose its tax-exempt status if UBTI that is incidentally derived from the holding of real property exceeds the 10-percent limitation, provided that the title- holding company establishes to the satisfaction of the Secretary of the Treasury that the receipt of UBTI in excess of the 10-percent limitation was inadvertent and reasonable steps are being taken to correct the circumstances giving rise to such excess UBTI.

Effective Date of New Federal Law

The provision is effective for taxable years beginning on or after January 1, 1994.

Impact on California Revenue

Combined with Act Section 13144.

A-IV-C: Training And Investment Incentives - Incentives For Investment In Real Estate - Provisions Relating To Real Estate Investments By Pension Funds

Public Law: 103-66

Act Section: 13147

Section Title: Exclusion From Unrelated Business Tax Of Gains From Certain Property

Prior Federal Law (Sec. 512(b))

In general, gains or losses from the sale, exchange or other disposition of property are excluded from UBTI. However, gains or losses from the sale, exchange or other disposition of property held primarily for sale to customers in the ordinary course of a trade or business are not excluded from UBTI (the "dealer UBTI rule").

Current California Law (Sec. 17651 and 23732)

California law is conformed to Section 512 of the Internal Revenue Code with certain specified exceptions relating to foreign organizations, clubs organized for pleasure or recreation, voluntary employees' beneficiary associations, supplemental unemployment compensation, qualified group legal services plans, and percentage limitations on amounts deductible from unrelated business taxable income (UBTI) as charitable contributions.

New Federal Law (Sec. 512(b))

The new law provides an exception to the dealer UBTI rule by excluding gains and losses from the sale, exchange or other disposition of certain real property and mortgages acquired from financial institutions that are in conservatorship or receivership. Only real property and mortgages owned by a financial institution (or that was security for a loan held by the financial institution) at the time that the institution entered conservatorship or receivership are eligible for the exception.

The exclusion is limited to properties designated as disposal property within nine months of acquisition, and disposed of within two and a half years of acquisition. The two and a half year disposition period may be extended by the Secretary if an extension is necessary for orderly liquidation of the property. No more than one-half by value of properties acquired in a single transaction may be designated as disposal property.

The exclusion is not available for properties that are improved or developed to the extent that the aggregate expenditures on development do not exceed 20 percent of the net selling price of the property.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Effective Date of New Federal Law

Applies to property acquired on or after January 1, 1994.

Impact on California Revenue

Combined with Act Section 13144.

A-IV-C: Training And Investment Incentives - Incentives For Investment In Real Estate - Provisions Relating To Real Estate Investments By Pension Funds

Public Law: 103-66

Act Section: 13148

Section Title: Exclusion From Unrelated Business Tax Of Certain Fees And Option Premiums

Prior Federal Law (Sec. 512(b))

Income from a trade or business that is unrelated to an exempt organization's purpose generally is UBTI. Passive income such as dividends, interest, royalties, and gains or losses from the sale, exchange or other disposition of property generally is excluded from UBTI. In addition, gains on the lapse or termination of options on securities are explicitly exempted from UBTI.

Present law is unclear on whether premiums from unexercised options on real estate and loan commitment fees are UBTI.

Current California Law (Sec. 17651 and 23732)

California law is conformed to Section 512 of the Internal Revenue Code with certain specified exceptions relating to foreign organizations, clubs organized for pleasure or recreation, voluntary employees' beneficiary associations, supplemental unemployment compensation, qualified group legal services plans, and percentage limitations on amounts deductible from unrelated business taxable income (UBTI) as charitable contributions.

New Federal Law (Sec. 512(b))

The new law expands the current exception for gains on the lapse or termination of options on securities to gains or losses from such options (without regard to whether they are written by the organization), from options on real property, and from the forfeiture of good-faith deposits (that are consistent with established business practice) for the purchase, sale or lease of real property.

In addition, the new law excludes loan commitment fees from UBTI. For purposes of this provision, loan commitment fees are non-refundable charges made by a lender to reserve a sum of money with fixed terms for a specified period of time. These charges are to compensate the lender for the risk inherent in committing to make the loan (e.g., for the lender's exposure to interest rate changes and for potential lost opportunities).

Effective Date of New Federal Law

Applies to amounts received on or after January 1, 1994.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

Combined with Act Section 13144.

A-IV-C: Training And Investment Incentives - Incentives For Investment In Real Estate - Provisions Relating To Real Estate Investments By Pension Funds

Public Law: 103-66

Act Section: 13149

Section Title: Treatment of Pension Fund Investments in Real Estate Investment Trusts

Prior Federal Law (Sec. 856)

A real estate investment trust ("REIT") is not taxed on income distributed to shareholders. A corporation does not qualify as a REIT if at any time during the last half of its taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by five or fewer individuals ("the five or fewer rule"). A domestic pension trust is treated as a single individual for purposes of this rule.

Dividends paid by a REIT are not UBTI, unless the stock in the REIT is debt-financed. Depending on its character, income earned by a partnership may be UBTI (Sec. 512(c)). Special rules treat debt-financed income earned by a partnership as UBTI (Sec. 514(c)(9)(B)(vi)).

Current California Law (Sec. 17740, 24870 and 24872)

California is conformed, by reference, to the definition of a REIT and the character of dividends from the REIT.

New Federal Law (Sec. 856(h))

The Revenue Reconciliation Act of 1993 provides that a pension trust generally is not treated as a single individual for purposes of the five-or-fewer rule. Rather, the act treats beneficiaries of the pension trust as holding stock in the REIT in proportion to their actuarial interests in the trust. This rule does not apply if disqualified persons, within the meaning of Section 4975(e)(2) (other than by reason of subparagraphs (B) and (I)), together own five percent or more of the value of the REIT stock and the REIT has earnings and profits attributable to a period during which it did not qualify as a REIT.

In addition, it provides that a REIT cannot be a personal holding company and, therefore, is not subject to the personal holding company tax on its undistributed income.

Unrelated business taxable income

Under the Revenue Reconciliation Act of 1993, certain pension trusts owning more than 10 percent of a REIT must treat a percentage of dividends from the REIT as UBTI. This percentage is the gross income derived from an unrelated trade or business (determined as if the REIT were a pension trust) divided by the gross income of the REIT for the year in which the dividends are paid. Dividends are not treated as UBTI, however, unless this percentage is at least five percent.

The UBTI rule applies only if the REIT qualifies as a REIT by reason of the above modification of the five or fewer rule. Moreover, the UBTI rule applies only if (1) one pension trust owns more than 25 percent of the value of the REIT, or (2) a group of pension trusts individually holding more than 10 percent of the value of the REIT collectively own more than 50 percent of the value of the REIT.

Effective Date of New Federal Law

The provision applies to taxable years beginning on or after January 1, 1994.

Impact on California Revenue

Combined with Act Section 13144.

A-IV-D: Training And Investment Incentives - Incentives For Investment In Real Estate - Discharge Of Indebtedness

Public Law: 103-66

Act Section: 13150

Section Title: Exclusion From Gross Income For Income From Discharge Of Qualified Real Property Business Indebtedness

Prior Federal Law (Sec. 108(a), 108(c), 108(d), 703(b), and 1017(b))

The discharge of indebtedness generally gives rise to gross income to the debtor taxpayer. Present law provides exceptions to this general rule. Among the exceptions are rules providing that income from the discharge of indebtedness of the taxpayer is excluded from income if the discharge occurs in a title 11 case, the discharge occurs when the taxpayer is insolvent, or in the case of certain farm indebtedness. The amount excluded from income under these exceptions is applied to reduce tax attributes of the taxpayer.

Current California Law (Sec. 17131, 17144, 17851, 17853, 18031, 24307 and 24918)

California conforms to federal law with certain modifications to make the reduction of tax attributes apply to state credits instead of federal credits and to reduce those credits by 11.1 cents per dollar versus the federal 33 1/3 cents per dollar. For purposes of limiting the amount excluded from income in the case of certain farm indebtedness, the California adjusted tax attribute for tax credits is modified to be $9 per $1 of tax credit versus the federal amount of $3 per $1 of the General Business Credit and the Foreign Tax Credit. These modifications reflect the difference in the rate of tax under federal and state laws.

New Federal Law (Sec. 108, 703 and 1017)

The Revenue Reconciliation Act of 1993 provides an election to taxpayers other than C corporations to exclude from gross income certain income from discharge of qualified real property business indebtedness. The amount so excluded cannot exceed the basis of certain depreciable real property of the taxpayer and is treated as a reduction in the basis of that property.

Qualified real property business indebtedness is indebtedness that (1) is incurred or assumed in connection with real property used in a trade or business, (2) is secured by that real property, and (3) with respect to which the taxpayer has made an election under this provision. Indebtedness incurred or assumed on or after January 1, 1993 is not qualified real property business indebtedness unless it is either (1) debt incurred to refinance qualified real property business debt incurred or assumed before that date (but only to the extent the amount of such debt does not exceed the amount of debt being refinanced) or (2) qualified acquisition indebtedness. Qualified real property business indebtedness does not include qualified farm indebtedness.

Qualified acquisition indebtedness is debt incurred to acquire, construct or substantially improve real property that is secured by such debt, and debt resulting from the refinancing of qualified acquisition debt, to the extent the amount of such debt does not exceed the amount of debt being refinanced.

The amount excluded under the provision with respect to the discharge of any qualified real property business indebtedness may not exceed the excess of (1) the outstanding principal amount of such debt (immediately before the discharge), over (2) the fair market value (immediately before the discharge) of the business real property which is security for the debt. For this purpose, the fair market value of the property is reduced by the outstanding principal amount of any other qualified real property indebtedness secured by the property immediately before the discharge.

The amount excluded under the provision also may not exceed the aggregate adjusted bases (determined as of the first day of the next taxable year or, if earlier, the date of disposition) of depreciable real property held by the taxpayer immediately before the discharge, determined after any reductions under subsections (b) and (g) of Section 108. The amount of debt discharge excluded under the provision is applied, using the rules of Section 1017 (as modified by the provision), to reduce the basis of business real property held by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge occurs.

The amount that is recaptured as ordinary income (under applicable recapture rules) is reduced over the time the taxpayer continues to hold the property, as the taxpayer forgoes depreciation deductions due to the basis reduction.

Effective Date of New Federal Law

Applies to discharges after December 31, 1992, in taxable years ending after that date.

Impact on California Revenue

The revenue loss for 1994-5 under the Personal Income Tax law is estimated to be $4 million based on federal projections.

A-IV-E: Training And Investment Incentives - Incentives for Investments in Real Estate - Increase in Recovery Period for Nonresidential Real Property

Public Law: 103-66

Act Section: 13151

Section Title: Increase In Recovery Period for Nonresidential Real Property

Prior Federal Law (Sec. 168(c))

A taxpayer is allowed to recover, through annual depreciation allowances, the cost or other basis of nonresidential real property (other than land) that is used in a trade or business or that is held for the production of rental income. For regular tax purposes, the amount of the depreciation deduction allowed with respect to nonresidential real property for any taxable year generally is determined by using the straight-line method and a recovery period of 31.5 years. For alternative minimum tax purposes, the amount of the depreciation deduction allowed with respect to nonresidential real property for any taxable year is determined by using the straight-line method and a recovery period of 40 years.

Current California Law (Sec. 17201, 23802, and 24349-24354.1)

Individuals and "S" Corporations. The Personal Income Tax Law is conformed to IRC Sec. 168, with respect to property placed in service on or after January 1, 1987. "S" corporations are permitted to compute their depreciation under the rules that apply to individuals. Property placed in service prior to January 1, 1987, continues to be depreciated under the federal Asset Depreciation Range (ADR) class life guidelines that were used by federal for property placed in service prior to 1981 (see Banks and Corporations, below).

Banks and Corporations. The Bank and Corporation Tax Law was not conformed to federal Accelerated Cost Recovery System (ACRS) in 1981, nor the modified system (MACRS) in 1987. Property continues to be depreciated under the federal Asset Depreciation Range (ADR) class life guidelines that were used by federal for property placed in service prior to 1981. Under the ADR Guidelines, class lives for nonresidential real property range from 40 to 60 years depending upon the type and use of the property. For example, hotels and theaters have a class life of 40 years while buildings used for wholesale and retail trade have a class life of 60 years.

New Federal Law (Sec. 168)

This provision requires the depreciation deduction allowed with respect to nonresidential real property for regular tax purposes to be determined by using a recovery period of 39 years. The provision does not change the depreciation deduction allowed with respect to nonresidential real property for alternative minimum tax purposes.

Effective Date of New Federal Law

Under the Revenue Reconciliation Act of 1993, the provision generally applies to property placed in service on or after May 13, 1993. The provision does not apply to property that a taxpayer places in service before January 1, 1994, if (1) the taxpayer or a qualified person entered into a binding written contract to purchase or construct the property before May 13, 1993, or (2) construction of the property was commenced by or for the taxpayer or a qualified person before May 13, 1993. A qualified person for this purpose is any person who transfers rights in such a contract or such property to the taxpayer, but only if the property is not placed in service by such person before such rights are transferred to the taxpayer.

The Conference Report contains a statement that the conferees wish to clarify that the provision does not change the recovery period of any property to which the ACRS amendments made by Section 201 of the Tax Reform Act of 1986 do not apply.

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be $1 million under the Personal Income Tax law based on state data.

A-V: Training And Investment Incentives - Luxury Tax

Public Law: 103-66

Act Section: 13161-13162

Section Title: Repeal of Luxury Excise Tax Other Than on Passenger Vehicles and Exemption From Luxury Excise Tax For Certain Equipment Installed on Passenger Vehicles For Use by Disabled Individuals

Prior Federal Law (Sec. 4001-4012)

Present law imposes a 10-percent excise tax on the portion of the retail price of the following items that exceeds the thresholds specified: automobiles above $30,000; boats above $100,000; aircraft above $250,000; jewelry above $10,000; and furs above $10,000. The tax also applies to subsequent purchases of component parts and accessories occurring within six months of the date the automobile, boat, or aircraft is placed in service.

The tax applies to sales before January 1, 2000.

Current California Law (Sec. None)

California does not impose a luxury tax.

New Federal Law (Sec. 4001-4004)

Repeal of luxury tax on boats, aircraft, jewelry, and furs

The Revenue Reconciliation Act of 1993 repeals the luxury excise tax imposed on boats, aircraft, jewelry, and furs.

Indexing of tax on automobiles

Provides that indexing will occur in increments of $ 2,000. The threshold for any year will be computed by increasing $30,000 by the cumulative inflation since 1990 with the result rounded down to the nearest increment of $2,000. The applicable threshold for purchases in 1993, on or after August 10, 1993, will be $30,000 increased by the 1991 and 1992 inflation rates (8.49 percent), or $32,547, which when rounded down to the nearest $2,000 is a threshold of $32,000.

Exemption for certain equipment installed on passenger vehicles for use by disabled individuals

Provides that the luxury excise tax does not apply to a part or accessory installed on a passenger vehicle to enable or assist an individual with a disability to operate the vehicle, or to enter or exit the vehicle, in order to compensate for the effect of the disability.

Exemption for demonstrator vehicles

Exempts passenger vehicle dealers from paying the luxury tax on vehicles used as demonstrators for potential customers. Under the provision, the tax, if any, is to be assessed and paid on the sales price of the vehicle when the vehicle is sold.

Effective Date of New Federal Law

Provide that indexation of the threshold applicable to passenger vehicles is effective for sales on or after the date of enactment.

Impact on California Revenue

Not applicable since California does not impose a luxury tax.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

A-V: Training And Investment Incentives - Luxury Tax

Public Law: 103-66

Act Section: 13163

Section Title: Tax on Diesel Fuel Used in Non-commercial Boats

Prior Federal Law (Sec. 4092)

Federal excise taxes generally are imposed on gasoline and special motor fuels used in highway transportation and by certain off-highway recreational trail vehicles and by motorboats (14 cents per gallon).

A Federal excise tax also is imposed on diesel fuel (20 cents per gallon) used in highway transportation. Diesel fuel used in motorboats is not currently taxed. Diesel fuel used in trains is taxed at 2.5 cents per gallon.

The revenues from these taxes, minus the 2.5-cents-per-gallon General Fund rate are deposited in various trust funds. Revenues from the remaining 2.5 cents per gallon are retained in the General Fund through September 30, 1995, after which time the 2.5-cents-per-gallon portion of the taxes (including the tax on diesel fuel used in trains) is scheduled to expire.

An additional 0.1-cent-per-gallon tax applies to these fuels to finance the Leaking Underground Storage Trust Fund, generally through December 31, 1995.

Current California Law

The Board of Equalization administers the motor vehicle fuel tax.

New Federal Law (Sec. 4092)

The Revenue Reconciliation Act of 1993 extends the current 20.1-cents-per-gallon diesel fuel excise taxes to diesel fuel used by noncommercial motorboats. Fuel used by boats for commercial fishing, transportation for compensation or hire, or for business use other than predominantly for entertainment, amusement, or recreation, remains exempt. Beginning on January 1, 1994, diesel fuel used by noncommercial motorboats also is subject to the 4.3 cents-per-gallon transportation fuels tax.

Effective Date of New Federal Law

The provision is effective after December 31, 1994.

Impact on California Revenue
To be determined by the Board of Equalization.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

A-VI: Training And Investment Incentives - Other Changes

Public Law: 103-66

Act Section: 13171

Section Title: Alternative Minimum Tax Treatment Of Contributions Of Appreciated Property

Prior Federal Law (Sec. 53(d), 56(g), and 57(d)

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization. However, in the case of a charitable contribution if inventory or other ordinary income property, short-term capital gain property, or certain gifts to private foundations, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to the adjusted basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.

For purposes of computing alternative minimum taxable income, the deduction for charitable contributions of capital gain property (real, personal, or intangible) is disallowed to the extent that the fair market value of the property exceeds its adjusted basis.

Current California Law (Sec. 17062, 23400, 23456, and 23457)

Individuals

California is conformed, by reference, to federal rules pertaining to alternative minimum tax.

The amount of tentative minimum tax is the alternative minimum taxable income (reduced by the exemption amount, if any) multiplied by 8.5% (the alternative minimum tax rate).

The tentative minimum tax will be computed using a rate of 7% for any taxable year beginning on or after January 1, 1996.

However, California specifically did not conform to a portion of the federal definition of "capital gain property." The portion to which California did not conform excludes certain "tangible personal property contributions" made in the 1991 taxable year or made before July 1, 1992 from that definition for purposes of computing the federal alternative minimum tax. This means that the excess of the fair market value over the taxpayer's adjusted basis with regard to those contributions is a tax preference item for California individuals, even though not a preference item for federal purposes.

Banks and Corporations

California is generally conformed to the federal rules pertaining to alternative minimum tax.

The alternative minimum tax is computed under the Bank and Corporation Tax Law at the rate of 7%.

However, for purposes of the Bank and Corporation Tax Law, California does not include as a preference item in computing the alternative minimum tax the excess of the fair market value (over the adjusted basis) of appreciated property that is contributed to charitable organizations. The reason for this is that the Bank and Corporation Tax Law does not allow the deduction for the fair market value of appreciated property to be deducted in the computation of the regular tax, so there is no tax preference item.

New Federal Law (Sec. 57(a), 56(g), and 53(d)(1)(B)(ii))

The treatment of contributions of appreciated property as a tax preference for alternative minimum tax purposes is eliminated. In addition, no adjustment related to earnings and profits effects of any charitable contribution is required to be made in computing the adjusted current earnings component of the corporate alternative minimum tax.

Effective Date of New Federal Law

Applies to contributions of tangible personal property made after June 30, 1992, and other contributions made after December 31, 1992.

Impact on California Revenue

The revenue loss for 1994-5 under the Personal Income Tax law is estimated to be $5 million.

A-VI: Training And Investment Incentives - Other Changes

Public Law: 103-66

Act Section: 13172

Section Title: Substantiation Requirement for Deduction of Certain Charitable Contributions

Prior Federal Law (Sec. 170)

An individual taxpayer who itemizes deductions must separately state (on Schedule A to the Form 1040) the aggregate amount of charitable contributions made by cash or check and the aggregate amount of donated property other than cash or check.

A taxpayer is not required to provide specific information on his or her return regarding a claimed charitable contribution made by cash or check; nor in such a case is a donee organization required to file an information return with the IRS, regardless of the amount of cash or check involved. However, taxpayers must provide certain information (on Form 8283) if the amount of the claimed deduction for all noncash contributions exceeds $500.

A payment to a charity (regardless of whether it is termed a "contribution") in exchange for which the payor receives an economic benefit is not deductible under Section 170, except to the extent that the taxpayer can demonstrate that the payment exceeds the fair market value of the benefit received from the charity.

Current California Law (Sec. 17201)

California is fully conformed by reference to federal law.

New Federal Law (Sec. 170)

Section 170 is amended to provide that no deduction is allowed under that section for a separate contribution of $250 or more unless the taxpayer has written substantiation from the donee organization of the contribution (including a good faith estimate of the value of any good or service that has been provided to the donor in exchange for making the gift to the donee).

This provision does not impose an information reporting requirement upon charities; rather, it places the responsibility upon taxpayers who claim an itemized deduction for a contribution of $250 or more to request (and maintain in their records) substantiation from the charity of their contribution (and any good or service received in exchange). Taxpayers may not rely solely on a canceled check as substantiation for a donation of $250 or more.

Under the provision, a taxpayer must obtain substantiation prior to filing his or her return for the taxable year in which the contribution was made (or if earlier, the due date, including extensions, for filing such return). Substantiation is not required if the donee organization files a return with the IRS (in accordance with Treasury regulations) reporting information sufficient to substantiate the amount of the deductible contribution.

The provision explicitly provides that, if in return for making a contribution of $250 or more to a religious organization, a donor receives in return solely an intangible religious benefit that generally is not sold in commercial transactions outside the donative context (e.g., admission to a religious ceremony), then such a religious benefit may be disregarded for purposes of the substantiation requirement.

Effective Date of New Federal Law

The provisions are effective for contributions made after December 31, 1993.

Impact on California Revenue

Combined with Act Section 13173.

A-VI: Training And Investment Incentives - Other Changes

Public Law: 103-66

Act Section: 13173

Section Title: Disclosure Related to Quid Pro Quo Contributions

Prior Federal Law (Sec. None)

The Code does not require a tax-exempt organization that is eligible to receive tax-deductible contributions to state explicitly, in its solicitations for support from members or the general public, whether an amount paid to the organization is deductible as a charitable contribution or whether all or part of the payment constitutes consideration for goods or services furnished to the payor. In contrast, tax-exempt organizations that are NOT eligible to receive tax-deductible contributions are required to state expressly in certain fund-raising solicitations that contributions or gifts to the organization are not deductible as charitable contributions for Federal income tax purposes (Sec. 6113). A penalty is imposed on such organizations for failure to comply with the Section 6113 disclosure requirement, unless reasonable cause is shown (Sec. 6710).

Tax-exempt organizations generally are required to file an annual information return (Form 990) with the IRS. However, churches (and their affiliated organizations), as well as tax-exempt organizations (other than private foundations) that normally have gross receipts in each taxable year of not more than $25,000, are not required to file the Form 990. If a charity is required to file a Form 990, then it must report, among other items, the names and addresses of all persons who contributed, bequeathed, or devised $5,000 or more (in cash or other property) during the taxable year.

Current California Law (Sec. None)

California does not require a tax-exempt organization that is eligible to receive tax-deductible contributions to state explicitly, in its solicitations for support from members of the general public, whether an amount paid to the organization is deductible as a charitable contribution or whether all or part of the payment constitutes consideration for goods or services furnished to the payor.

New Federal Law (Sec. 6115(new) and 6714 (new))

A charitable organization that receives a quid pro quo contribution in excess of $75 (meaning a payment exceeding $75 "made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization") is required, in connection with the solicitation or receipt of such a contribution, to provide a written statement to the donor that (1) informs the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of the amount of any money (and the value of any property other than money) contributed by the donor over the value of the goods or services provided by the organization, and (2) provides the donor with a good faith estimate of the value of goods or services furnished to the donor by the organization.

The disclosure requirement applies to all pro quo contributions where the donor makes a payment of more than $75. Thus, for example, if a charity receives a $100 contribution from a donor, in exchange for which the donor receives a dinner valued at $40, then the charity must inform the donor in writing that only $60 is deductible as a charitable contribution. However, the provision does not apply if only de minimis, token goods or services are given to a donor. In addition, the provision does not apply to a contribution in return for which the contributor receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context. Furthermore, the provision does not apply to transactions that have no donative element (e.g., sales of goods by a museum gift shop that are not, in part, donations).

The provision also provides that penalties ($10 per contribution, but capped at $5,000 per particular fundraising event or mailing) may be imposed upon charities that fail to make the required disclosure, unless the failure was due to reasonable cause. The penalties will apply if an organization either fails to make any disclosure in connection with a quid pro quo contribution or makes a disclosure that is incomplete or inaccurate (e.g., an estimate not determined in good faith of the value of goods or services furnished to the donor).

Effective Date of New Federal Law

The provisions are effective for contributions made after December 31, 1993.

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be $5 million based on federal projections. This gain will largely occur automatically at the state level as a result of the federal requirements. Note: This estimate also includes the impact of conforming to Act Section 13172.

A-VI: Training And Investment Incentives - Other Changes

Public Law: 103-66

Act Section: 13174

Section Title: Temporary Extension of Health Insurance Deduction for Self-Employed Individuals

Prior Federal Law (Sec. 162(l))

An incorporated business can generally deduct as an employee compensation expense, the full cost of any health insurance coverage provided for its employees (including owners serving as employees) and its employees' spouses and dependents. Self-employed individuals can fully deduct the cost of health insurance for employees as employee compensation, but can only deduct the cost of health insurance coverage for the individual and his or her dependents to the extent that the cost of the coverage, together with other allowable medical expenses, exceeds 7.5 percent of adjusted gross income. Other individuals (e.g., employees who are not covered by an employer-sponsored plan) who purchase health insurance can deduct the cost of the insurance only to the extent that it, together with their other medical expenses, exceeds 7.5 percent of adjusted gross income.

For coverage prior to July 1, 1992, a self-employed individual was allowed to deduct as a business expense up to 25 percent of the amount paid for health insurance coverage of the taxpayer, the taxpayer's spouse, and the taxpayer's dependents. Only amounts paid prior to July 1, 1992, for coverage before that date were eligible for the deduction. The deduction was not allowed if the self-employed individual or his or her spouse was eligible for employer-paid health benefits.

Current California Law (Sec. 17201, and 17273)

California is conformed, by reference, to federal rules that pertain to trade or business expenses except that California deliberately enacted a provision to make the federal termination date relating to health insurance costs of self-employed individuals inapplicable. California specifically provides that the state deduction is available only in those taxable years (or portion thereof) that a deduction is allowed for federal purposes.

This means that any extension of the federal deduction extends the existing state provision. However, federal law changes other than an extension of the existing deduction, become state law only after legislative action.

New Federal Law (Sec. 162(l)(6))

The 25 percent deduction is extended retroactively from July 1, 1992, though December 31, 1993. In addition, the determination of whether a self-employed individual or his or her spouse are eligible for employer paid health benefits is made on a monthly basis.

Effective Date of New Federal Law

Applies to taxable years ending after June 30, 1992.

Impact on California Revenue

The retroactive impact of this provision is estimated to be $30 million. The extension issue is a current law provision.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

<u>B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases</u>

<u>Public Law:</u> 103-66

<u>Act Section:</u> 13201

<u>Section Title:</u> Increase In Top Marginal Rate Under Section 1

<u>Prior Federal Law (Sec. 1, 41(e), 63(c), 68(b), 132(f), 151(d), 513(h), 531, and 541)</u>

Regular tax rates

For 1993, the individual income tax rates are as follows -- If taxable income is: Then income tax equals:

Single individuals

$ 0-$ 22,100	15 percent of taxable income.
$ 22,100-$ 53,500	$3,315.00 plus 28% of the amount over $22,100.
Over $ 53,500	$12,107.00 plus 31% of the amount over $ 53,500.

Heads of household

$ 0-$ 29,600	15 percent of taxable income.
$ 29,600-$ 76,400	$4,440.00 plus 28% of the amount over $ 29,600.
Over $ 76,400	$17,544.00 plus 31% of the amount over $ 76,400.

Married individuals filing joint returns

$ 0-$ 36,900	15 percent of taxable income.
$ 36,900-$ 89,150	$5,535 plus 28% of the amount over $ 36,900.
Over $ 89,150	$20,165 plus 31% of the amount over $ 89,150.

Married individuals filing separate returns

\$ 0-\$ 18,450	15 percent of taxable income.
\$ 18,450-\$ 44,575	\$2,767.50 plus 28% of the amount over \$ 18,450.
Over \$ 44,575	\$10,082.50 plus 31% of the amount over \$ 44,575.

Estates and trusts

\$ 0-\$ 3,750	15 percent of taxable income.
\$ 3,750-\$ 11,250	\$562.50 plus 28% of the amount over \$ 3,750.
Over \$ 11,250	\$2,662.50 plus 31% of the amount over \$ 11,250.

Net capital gains income is subject to a maximum tax rate of 28 percent.

The individual income tax brackets are indexed each year for inflation.

<u>Current California Law (Sec. 17041)</u>

The Personal Income Tax Law, relating to individuals, estates, and trusts, provides for a series of graduated tax rates and income brackets which are applied to taxable income after deductions (standard or itemized) have been allowed. For 1992, the rates and brackets are as follows:

Marginal Rate	Single Persons	Head of Household	Married Couples
1 %	0 - 4,552	0 - 9,105	0 - 9,104
2 %	4,552 - 10,789	9,105 - 21,579	9,104 - 21,578
4 %	10,789 - 17,027	21,579 - 27,815	21,578 - 34,054
6 %	17,027 - 23,637	27,815 - 34,425	34,054 - 47,274
8 %	23,637 - 29,873	34,425 - 40,662	47,274 - 59,746
9.3 %	29,873 - 103,600	40,662 - 141,015	59,746 - 207,200
10 %	103,600 - 207,200	141,015 - 282,030	207,200 - 414,400
11 %	207,200 and over	282,030 and over	414,400 and over

<u>New Federal Law (Sec. 1)</u>

The Revenue Reconciliation Act of 1993 imposes a new 36-percent marginal tax rate on taxable income in excess of the following thresholds:

Filing status	Applicable threshold
Married individuals filing joint returns	\$ 140,000
Heads of households	\$ 127,500
Unmarried individuals	\$ 115,000
Married individuals filing separate returns	\$ 70,000
Estates and trusts	\$ 5,500

For estates and trusts, the 15-percent rate applies to income up to $1,500, the 28-percent rate applies to income between $1,500 and $3,500, and the 31-percent rate applies to income between $3,500 and $5,500.

As under present law, the tax rate bracket thresholds are indexed for inflation. However, indexing of thresholds for the 36-percent rate applies to taxable years beginning after December 31, 1994.

Effective Date of New Federal Law

Applies to taxable years beginning after December 31, 1992. Penalties for underpayment of estimated taxes will be waived for amounts attributable to changes in tax rates.

In addition, the Revenue Reconciliation Act of 1993 contains a provision permitting individual taxpayers to elect to pay their additional 1993 taxes that are attributable to the rate increases in three annual installments. The first installment must be paid on or before the due date for the individual's taxable year that begins in calendar year 1993; the second installment must be paid on or before the date one year after that date; and the third installment must be paid on or before the date two years after that date. The election must be made on the tax return for the individual's taxable year that begins in 1993 (which, in general, is due on April 15, 1994).

The amount eligible for this installment payment election is the excess of the individual's net liability under Chapter 1 of the Internal Revenue Code as shown on the individual's tax return over the amount that would have been the individual's net liability but for the amendments made by the Revenue Reconciliation Act of 1993 that alter the individual tax rates. These amounts are computed after the application of any credit (except the credit for wage withholding and the credit for special fuel uses) and before crediting any payment of estimated tax. Amounts required to be shown on the return but not actually shown on the return are ineligible for this installment payment election.

The Secretary must immediately terminate this installment payment election, and the whole amount of the unpaid tax shall be paid immediately upon notice and demand from the Secretary, if either (1) the taxpayer does not pay any installment on or before the required date, or (2) the Secretary believes that the collection of any amount under this installment payment election is in jeopardy.

Because this installment payment election applies only to amounts actually shown on the individual's tax return, those amounts are considered to be assessed. Consequently, the 10-year statute of limitations applicable to collection after assessment (Sec. 6502) is applicable to these installment payments.

Impact on California Revenue

Not applicable, since California differs from federal in tax rates and income brackets.

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases

Public Law: 103-66

Act Section: 13202

Section Title: Surtax on High Income Taxpayers

Prior Federal Law (Sec. 1, 531, and 541)

Under present law, there is no surtax imposed on higher-income individuals.

Current California Law (Sec. 17041)

There is no surtax under current law.

New Federal Law (Sec. 1)

The Revenue Reconciliation Act of 1993 provides a 10-percent surtax on individuals with taxable income in excess of $250,000 and on estates and trusts with taxable income in excess of $7,500.

For married taxpayers filing separate returns, the threshold amount for the surtax is $125,000.

The surtax is computed by applying a 39.6-percent rate to taxable income in excess of the applicable threshold. Under this method of computation, unlike a simple 10-percent increase in tax liability, net capital gain income is not subject to tax at a rate in excess of the current 28-percent maximum rate.

The thresholds for the surtax are indexed for inflation in the same manner as other individual income tax rate thresholds for taxable years beginning after December 31, 1994.

Effective Date of New Federal Law

Applies to taxable years beginning after December 31, 1992.

Penalties for underpayment of estimated taxes will be waived for amounts attributable to changes in tax rates.

Impact on California Revenue

Not applicable, since California differs from federal in tax rates and brackets.

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases

Public Law: 103-66

Act Section: 13203

Section Title: Modifications to Alternative Minimum Tax Rates and Exemption Amounts

Prior Federal Law (Sec. 55(b), 55(d), and 897(a))

An individual taxpayer is subject to an alternative minimum tax (AMT) to the extent that the taxpayer's tentative minimum tax exceeds the taxpayer's regular tax liability. A taxpayer's tentative minimum tax generally equals 24 percent of alternative minimum taxable income (AMTI) in excess of an exemption amount.

The exemption amount is $40,000 for married taxpayers filing joint returns, $30,000 for unmarried taxpayers filing as single or head of household, and $20,000 for married taxpayers filing separate returns, estates, and trusts. The exemption amount is phased out for taxpayers with AMTI above specified thresholds. These thresholds are:

$150,000 for married taxpayers filing joint returns,

$112,500 for unmarried taxpayers filing as single or head of household, and

$75,000 for married taxpayers filing separate returns, estates, and trusts.

The exemption is completely phased out for individuals with AMTI above $310,000 (married taxpayers filing joint returns) or $232,500 (unmarried taxpayers filing as single or head of household). The exemption amount and the thresholds are not indexed for inflation.

Current California Law (Sec. 17062)

California is fully conformed to federal exemption amounts for the purpose of computing the Alternative Minimum Tax (AMT), including the allowance of exemptions as deductions from income, rather than in the form of credits against the tax (as is done in computing the regular tax).

The tax rate is 8.5 percent for AMT purposes and bears approximately the same ratio to the highest marginal tax rate for regular tax purposes as under federal law:

Maximum Tax Rate		AMT Rate	Ratio
Federal	31.0	24.0	.774
California	11.0	8.5	.772

New Federal Law (Sec. 55, 894-898)

The Revenue Reconciliation Act of 1993 provides a two-tiered graduated rate schedule for the AMT for taxpayers other than corporations. A 26-percent rate applies to the first $175,000 of a taxpayer's AMTI in excess of the exemption amount, and a 28-percent rate applies to AMTI more than $175,000 above the exemption amount. For married individuals filing separate returns, the 28-percent rate applies to AMTI more than $87,500 above the exemption amount.

The Revenue Reconciliation Act of 1993 increases the exemption amount to $45,000 for married individuals filing joint returns, to $33,750 for unmarried individuals, and to $22,500 for married individuals filing separate returns, estates, and trusts.

Effective Date of New Federal Law

Applies to taxable years beginning after December 31, 1992. Penalties for underpayment of estimated taxes will be waived for amounts attributable to changes in tax rates.

Impact on California Revenue

Based on the department's tax model, if California were to conform to a comparable AMT rate structure (7% under $175,000, 8.5% over $175,000) and revise exemptions to be the same as federal, the revenue loss is estimated to be $120 million for 1994.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases

Public Law: 103-66

Act Section: 13204

Section Title: Overall Limitation on Itemized Deductions for High-Income Taxpayers Made Permanent

Prior Federal Law (Sec. 68(f))

Individuals who do not elect the standard deduction may claim itemized deductions (subject to certain limitations) for certain expenses incurred during the taxable year. Among these deductible expenses are unreimbursed medical expenses, unreimbursed casualty and theft losses, charitable contributions, qualified residence interest, State and local income and property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Certain itemized deductions are allowed only to the extent that the amount exceeds a specified percentage of the taxpayer's adjusted gross income (AGI). Unreimbursed medical expenses for care of the taxpayer and the taxpayer's spouse and dependents are deductible only to the extent that the total of these expenses exceeds 7.5 percent of the taxpayer's AGI. Nonbusiness, unreimbursed casualty or theft losses are deductible only to the extent that the amount of loss arising from each casualty or theft exceeds $100 and only to the extent that the net amount of casualty and theft losses exceeds 10 percent of the taxpayer's AGI. Unreimbursed employee business expenses and certain other miscellaneous expenses are deductible only to the extent that the total of these expenses exceeds 2 percent of the taxpayer's AGI.

The total amount of otherwise allowable itemized deductions (other than medical expenses, casualty and theft losses, and investment interest) is reduced by 3 percent of the amount of the taxpayer's AGI in excess of $108,450 in 1993 (indexed for inflation). Under this provision, otherwise allowable itemized deductions may not be reduced by more than 80 percent. In computing the reduction of total itemized deductions, all present-law limitations applicable to such deductions are first applied and then the otherwise allowable total amount of deductions is reduced in accordance with this provision.

The reduction of otherwise allowable itemized deductions does not apply to taxable years beginning after December 31, 1995.

Current California Law (Sec. 17077)

California limits the amount of itemized deductions which certain high income taxpayers may deduct in a manner similar to federal law. However, the indexed threshold amount is higher than the federal amount, the phase-out rate is 6 percent rather than 3 percent and the limitation is permanent.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

New Federal Law (Sec. 68)

The Revenue Reconciliation Act of 1993 makes permanent the provision that limits itemized deductions.

Effective Date of New Federal Law

The provision is effective for taxable years beginning after December 31, 1992.

Impact on California Revenue

None. The California limitation on itemized deductions is already a permanent provision.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases

Public Law: 103-66

Act Section: 13205

Section Title: Phaseout of Personal Exemption of High-Income Taxpayers Made Permanent

Prior Federal Law (Sec. 151()(3))

Present law permits a personal exemption deduction from gross income for an individual, the individual's spouse and each dependent. For 1993, the amount of this deduction is $2,350 for each exemption claimed. This exemption amount is adjusted for inflation. The deduction for personal exemptions is phased out for taxpayers with AGI above a threshold amount (indexed for inflation) which is based on filing status. For 1993, the threshold amounts are $162,700 for married taxpayers filing joint returns, $81,350 for married taxpayers filing separate returns, $135,600 for unmarried taxpayers filing as head of household, and $108,450 for unmarried taxpayers filing as single.

The total amount of exemptions that may be claimed by a taxpayer is reduced by 2 percent for each $2,500 (or portion thereof) by which the taxpayer's AGI exceeds the applicable threshold. (The phaseout rate is 2 percent for each $1,250 for married taxpayers filing separate returns.) Thus, the personal exemptions claimed are phased out over a $122,500 range (which is not indexed for inflation), beginning at the applicable threshold.

This provision does not apply to taxable years beginning after December 31, 1996.

Current California Law (Sec. 17054.1)

The California credits for personal exemptions are phased-out for certain high income taxpayers in a manner similar to federal law. The California phase-out provisions, however, are permanent.

New Federal Law (Sec. 151(d)(3))

The Revenue Reconciliation Act of 1993 makes permanent the provision that phases out personal exemptions.

Effective Date of New Federal Law

The provision is effective for taxable years beginning after December 31, 1992.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

None. The California phaseout of personal exemptions is already a permanent provision.

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases - Provisions To Prevent Conversion Of Ordinary Income To Capital Gain

Public Law: 103-66

Act Section: 13206(a)

Section Title: Interest Imbedded In Financial Transactions

Prior Federal Law (Sec. 1258 (new))

Under present law, the maximum rate of individual income tax on ordinary income is 31 percent. Interest from a loan generally is treated as ordinary income.

Gain or loss from the sale or exchange of a capital asset generally is treated as capital gain or loss. Net capital gain (i.e., net long-term capital gain less net short-term capital loss) of an individual is subject to a maximum tax rate of 28 percent. Generally, capital losses are not deductible against ordinary income.

Current California Law (Sec.18151 and 24990)

California is conformed to the treatment of gain or loss from the sale or exchange of a capital asset except that capital losses are not allowed to be carried back to prior years and there is no special tax rate for net long-term capital gain. The amounts of gain reported on the state return often are different from the federal amount because of the differences in the adjusted basis of the asset sold or exchanged due to differences in the amount of depreciation allowed on property acquired before 1987.

New Federal Law (Sec. 1258)

Under the provision, capital gain from the disposition of property that was part of a "conversion transaction" would be recharacterized as ordinary income, with certain limitations discussed below. No inference is intended as to when income from a conversion transaction is properly treated as capital gain under present law.

A conversion transaction is a transaction, generally consisting of two or more positions taken with regard to the same or similar property, where substantially all of the taxpayer's return is attributable to the time value of the taxpayer's net investment in the transaction. In a conversion transaction, the taxpayer is in the economic position of a lender -- he has an expectation of a return from the transaction which in substance is in the nature of interest and he undertakes no significant risks other than those typical of a lender. However, a transaction is not a conversion transaction subject to the provision unless it also satisfies one of the following four criteria: (1) the transaction consists of the acquisition of property by the taxpayer and a substantially contemporaneous agreement to sell the same or substantially identical property in the future; (2) the transaction is a straddle, within the meaning of Section 1092; (3) the transaction is one that was marketed or sold to the taxpayer on the basis that it would have the economic characteristics of a loan but the interest-like return would be taxed as capital gain; or (4) the transaction is described as a conversion transaction in regulations promulgated by the Secretary of the Treasury. Property or positions may be part of a conversion transaction, and transactions of options dealers and commodities traders in the normal course of their trade or business of dealing in options or Section 1256 contracts, respectively, generally will not be considered to be conversion transactions, except as provided in special rules. Special rules limit the availability of the options dealer and commodities trader exception for limited partners or limited entrepreneurs in an entity that is an options dealer or a commodities trader.

The term "commodities trader" includes any person who is a member of a domestic board of trade (including a member having member trading privileges only with respect to a portion of the contracts available for trading on the board of trade) which is designated as a contract market by the Commodity Futures Trading Commission. "Commodities trader" also, except as otherwise provided by Treasury regulations, includes a person entitled to trade as a member, such as a lessee of a membership or an entity that is (or is affiliated with) a beneficial owner of a membership if such entity is eligible for any preferential rates available to members with respect to transaction fees or margins imposed by the board of trade or for the clearing of trades on the board of trade. Other persons eligible for such member rates also will be treated as "commodities traders" for purposes of the exception; however, the Secretary may promulgate regulations that prevent unwarranted expansion of the exception, by excluding from the definition of "commodities trader" a person who acquires some attributes of board of trade membership for the principal purpose of qualifying for the "commodities trader" exception or whose margins or fees are substantially more than the margins or fees associated with owned or leased memberships.

Under the provision, gain realized by a taxpayer from a conversion transaction that would otherwise be treated as capital gain will be treated as ordinary income (but not as interest) for all purposes of the Internal Revenue Code. The amount of gain so recharacterized will not exceed the amount of interest that would have accrued on the taxpayer's net investment for the relevant period at a yield equal to 120% of the "applicable rate". This limit is subject to appropriate reduction to reflect prior inclusion of ordinary income items from the conversion transaction or the capitalization of interest on acquisition indebtedness under Section 263(g). The "applicable rate" is the applicable Federal rate under Section 1274(d) at the time the taxpayer enters into the conversion transaction (if the conversion transaction has a definite term) or the Federal short term rate determined under Section 6621(b) (if the conversion transaction has an indefinite term). The Secretary is given the authority (under Sec. 1274(d)(1)(D)) to provide for the use of an applicable rate lower than the applicable Federal rate in appropriate cases.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Effective Date of New Federal Law

Applies to conversion transactions entered into after April 30, 1993.

Impact on California Revenue

Federal estimates reflect all provisions dealing with ordinary income characterization and are not particularly significant. Potential revenue gains for California would be even less significant given the fact that no differential tax rate exists between ordinary income and capital gain income. The revenue gain for 1994-5 would probably not exceed $1 million and would reflect limitations on capital loss deductions. (This estimate includes Act Section 13206(a) through (e)).

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases - Provisions To Prevent Conversion Of Ordinary Income To Capital Gain

Public Law: 103-66

Act Section: 13206(b)

Section Title: Repeal of Certain Exceptions to the Market Discount Rules

Prior Federal Law (Sec. 1276(e), 1277(d), and 1278(a))

Generally, a market discount bond is a bond that is acquired for a price that is less than the principal amount of the bond. Market discount generally arises when the value of a debt obligation declines after issuance (typically, because of an increase in prevailing interest rates or a decline in the credit-worthiness of the borrower).

Gain on the disposition of a market discount bond generally must be recognized as ordinary income to the extent of the market discount that has accrued. This ordinary income rule, however, does not apply to tax-exempt obligations or to market discount bonds issued on or before July 18, 1984. Under current law, income attributable to accrued market discount on tax-exempt bonds is not tax-exempt but is taxable as capital gain if the bond is held as a capital asset.

Current California Law (Sec. 18151 and 24990)

California is fully conformed to federal law with respect to bonds issued after 1984. California has special transitional rules that apply to bonds issued in 1984 and require an adjustment to be made in the year of maturity.

New Federal Law (Sec. 1276(e), 1277(d), and 1278(a))

The Revenue Reconciliation Act of 1993 extends the ordinary income rule to tax-exempt obligations and to market discount bonds issued on or before July 18, 1984. Thus, gain on the disposition of a tax-exempt obligation or any other market discount bond that is acquired for a price that is less than the principal amount of the bond generally will be treated as ordinary income (instead of capital gain) to the extent of accrued market discount.

Effective Date of New Federal Law

Applies to bonds purchased after April 30, 1993. Thus, current owners of tax-exempt bonds and other market discount bonds issued on or before July 18, 1984, will not be required to treat accrued market discount as ordinary income, if they acquired their bonds before May 1, 1993.

Impact on California Revenue

Estimate included in Act Section 13206(a).

Rate Increases - Provisions To Prevent Conversion Of Ordinary Income To Capital Gain

Public Law: 103-66

Act Section: 13206(c)

Section Title: Accrual of Income by Holders of Stripped Preferred Stock

Prior Federal Law (Sec. 167(e) and 305(e))

In general, if a bond is issued at a price approximately equal to its redemption price at maturity, the expected return to the holder of the bond is in the form of periodic interest payments. In the case of original issue discount ("OID") bonds, however, the issue price is below the redemption price, and the holder receives part or all of his expected return in the form of price appreciation. The difference between the issue price and the redemption price is the OID, and a portion of the OID is required to be accrued and included in the income of the holder annually. Similarly, for certain preferred stock that is issued at a discount from its redemption price, a portion of the redemption premium must be included in income annually.

A stripped bond (i.e., a bond issued with interest coupons some of which are subsequently "stripped" so that the ownership of the bond is separated from the ownership of the interest coupons) generally is treated as a bond issued with OID equal to (1) the stated redemption price of the bond at maturity minus (2) the amount paid for the stripped bond.

If preferred stock is stripped of some of its dividend rights, however, the stripped stock is not subject to the rules that apply to stripped bonds or to the rules that apply to bonds and certain preferred stock issued at a discount.

Current California Law (Sec. 17321 and 24451)

California is fully conformed to federal law.

New Federal Law (Sec. 167(e) and 305)

The Revenue Reconciliation Act of 1993 treats the purchaser of stripped preferred stock (and a person who strips preferred stock and disposes of the stripped dividend rights) in generally the same way that the purchaser of a stripped bond would be treated under the OID rules. Thus, stripped stock is treated like a bond issued with OID equal to (1) the stated redemption price of the stock minus (2) the amount paid for the stock. The discount accrued under the provision is treated as ordinary income and not as interest or dividends.

Stripped preferred stock is defined as any preferred stock where the ownership of the stock has been separated from the right to receive any dividend that has not yet become payable. The provision applies to stock that is limited and preferred as to dividends, does not participate in corporate growth to any significant extent, and has a fixed redemption price.

The legislative history for this provision contains a statement that no inference is intended as to the treatment of stripped preferred stock for tax purposes with respect to any issues not directly addressed by this legislation, including the availability of the dividends received deduction to a holder of dividends stripped from preferred stock, the allocation of basis by the creator of stripped preferred stock, or the proper characterization of a purported sale of stripped dividend rights.

Effective Date of New Federal Law

Became effective for stripped stock that is purchased after April 30, 1993.

Impact on California Revenue

Estimate included in Act Section 13206(a).

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases - Provisions To Prevent Conversion Of Ordinary Income To Capital Gain

Public Law: 103-66

Act Section: 13206(d)

Section Title: Treatment of Net Capital Gains as Investment Income

Prior Federal Law (Sec. 1(h) and 163(d))

In the case of a taxpayer other than a corporation, deductions for interest on indebtedness that is allocable to property held for investment ("investment interest") are limited to the taxpayer's net investment income for the taxable year. Disallowed investment interest is carried forward to the next taxable year. Investment income includes gross income (other than gain on disposition) from property held for investment and any net gain attributable to the disposition of property held for investment.

Investment interest that is allowable is deductible against income taxable at ordinary income rates. The net capital gain (i.e., net long-term capital gain less net short-term capital loss) of a noncorporate taxpayer is taxed at a maximum rate of 28 percent.

Prior to 1986, when a significant rate differential existed between long-term capital gains and ordinary income, long-term capital gains were not included in investment income for purposes of computing the investment interest limitation.

Current California Law (Sec. 17201)

California is completely conformed with the federal rules for investment interest expense. The California deduction for investment interest expense may differ due to the taxability of federal bonds and bonds of states other than California for federal purposes.

New Federal Law (Sec. 1(h) and 163(d))

The Revenue Reconciliation Act of 1993 generally excludes net capital gain attributable to the disposition of property held for investment from investment income for purposes of computing the investment interest limitation. A taxpayer, however, can elect to include so much of his net capital gain in investment income as the taxpayer chooses if he also reduces the amount of net capital gain eligible for the 28-percent maximum capital gains rate by the same amount.

Effective Date of New Federal Law

Applies to taxable years beginning after December 31, 1992.

Impact on California Revenue

Estimate included in Act Section 13206(a).

B-I-A: Revenue Increases - Provisions Affecting Individuals - Rate Increases

Public Law: 103-66

Act Section: 13206(e)

Section Title: Treatment of Certain Appreciated Inventory

Prior Federal Law (Sec. 751(d))

Under present law, amounts received by a partner in exchange for his interest in a partnership are treated as ordinary income to the extent they are attributable to substantially appreciated inventory of the partnership. In addition, distributions by a partnership in which a partner receives substantially appreciated inventory in exchange for his interest in certain other partnership property (or receives certain other property in exchange for substantially appreciated inventory) are treated as a taxable sale or exchange of property, rather than as a nontaxable distribution.

For these purposes, inventory is treated as substantially appreciated if the value of the partnership's inventory exceeds both 120 percent of its adjusted basis and 10 percent of the value of all partnership property (other than money).

Current California Law (Sec. 17851 and 17856)

California conforms to federal law except with respect to the provision making appreciated inventory items subject to tax as gain on foreign investment company stock.

New Federal Law (Sec. 751)

The Revenue Reconciliation Act of 1993 eliminates the requirement that the partnership's inventory exceed 10 percent of the value of all partnership property in order to be substantially appreciated. Thus, if the partnership's inventory is worth more than 120 percent of its adjusted basis, the inventory is treated as substantially appreciated. In addition, any inventory property acquired with a principal purpose to reduce the appreciation to less than 120 percent in order to avoid ordinary income treatment will be disregarded in applying the 120-percent test.

Effective Date of New Federal Law

Applies to sales, exchanges, and distributions after April 30, 1993.

Impact on California Revenue

Estimate included in Act Section 13206(a).

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13207

Section Title: Repeal of Limitation on Amount of Wages Subject to Health Insurance Employment Tax

Prior Federal Law (Sec. 3121(x))

As part of the Federal Insurance Contributions Act (FICA), a tax is imposed on employees and employers up to a maximum amount of employee wages. The tax is comprised of two parts: old-age, survivor, and disability insurance (OASDI) and Medicare hospital insurance (HI). For wages paid in 1993 to covered employees, the HI tax rate is 1.45 percent on both the employer and the employee on the first $135,000 of wages and the OASDI tax rate is 6.2 percent on both the employer and the employee on the first $57,600 of wages.

Under the Self-Employment Contributions Act of 1954 (SECA), a tax is imposed on an individual's self-employment income. The self- employment tax rate is the same as the total rate for employers and employees (i.e., 2.9 percent for HI and 12.40 percent for OASDI). For 1993, the HI tax is applied to the first $135,000 of self-employment income and the OASDI tax is applied to the first $57,600 self-employment income. In general, the tax is reduced to the extent that the individual had wages for which employment taxes were withheld during the year.

The cap on wages and self-employment income subject to FICA and SECA taxes is indexed to changes in the average wages in the economy.

Current California Law (Sec. None)

California does not impose FICA or SECA taxes.

New Federal Law (Sec. 1402, 3121, 3122, 3123 and 6413)

The Revenue Reconciliation Act of 1993 repeals to dollar limit on wages and self-employment income subject to HI taxes.

Effective Date of New Federal Law

The provision is effective for wages and income received after December 31, 1993.

Impact on California Revenue

Not applicable.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13208

Section Title: Top Estate And Gift Tax Rates Made Permanent

Prior Federal Law (Sec. 2001)

A Federal gift tax is imposed on transfers by gift during life and a Federal estate tax is imposed on transfers at death. The Federal estate and gift taxes are unified, so that a single graduated rate schedule is applied to an individual's cumulative gifts and bequests. For decedents dying (or gifts made) after 1992, the estate and gift tax rates begin at 18 percent on the first $10,000 of taxable transfers and reach a maximum of 50 percent on taxable transfers over $2.5 million. Previously, for the nine-year period beginning after 1983 and ending before 1993, two additional brackets applied at the top of the rate schedule: a rate of 53 percent on taxable transfers exceeding $2.5 million and below $3 million, and a maximum marginal tax rate of 55 percent on taxable transfers exceeding $ 3 million. The generation-skipping transfer tax is computed by reference to the maximum Federal estate tax rate (Sec. 2641).

In order to phase out the benefit of the graduated brackets and unified credit, the estate and gift tax is increased by five percent on cumulative taxable transfers between $10 million and $18,340,000, for decedents dying and gifts made after 1992. (Prior to 1993, this phase out of the graduated rates and unified credit applied to cumulative taxable transfers between $10 million and $21,040,000.)

Current California Law (Sec. None)

California does not impose a gift tax and the California estate tax is a "pick-up" tax, that is, the state tax is equal to the maximum credit for a state tax on the federal estate tax return for that particular decedent's estate. This "pick-up" tax is administered by the State Controller's Office.

New Federal Law (Sec. 2001)

The Revenue Reconciliation Act of 1993 provides that, for taxable transfers over $2.5 million but not over $3 million, the estate and gift tax rate is 53 percent. For taxable transfers over $3 million, the estate and gift tax rate is 55 percent. The phase out of the graduated rates and unified credit applies with respect to cumulative taxable transfers between $10 million and $21,040,000. Also, since the generation- skipping transfer tax is computed by reference to the maximum Federal estate tax rate, the rate of tax on generation-skipping transfers is 55 percent.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Effective Date of New Federal Law

This provision is effective for decedents dying, gifts made, and generation skipping transfers occurring after December 31, 1992.

Impact on California Revenue

Subject to review by the State Controller's Office.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13209

Section Title: Reduction in Deductible Portion of Business Meals And Entertainment Expenses

Prior Federal Law (Sec. 274)

In general, a taxpayer is permitted a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business and, in the case of an individual, for the production of income. No deduction generally is allowed for personal, living, or family expenses.

Meal and entertainment expenses incurred for business or investment reasons are deductible if certain legal and substantiation requirements are met. The amount of the deduction generally is limited to 80 percent of the expense that meets these requirements. No deduction is allowed, however, for meal or beverage expenses that are lavish or extravagant under the circumstances.

No deduction is allowed with respect to business meal and entertainment expenses (as well as other specified items) unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (1) the amount of the expense, (2) the time and place of the expense, (3) the business purpose of the expense, and (4) the business relationship to the taxpayer of the persons entertained. Under Treasury regulations, such documentary evidence is required for expenditures of $25 or more (Treas. Reg. 1.274-5T(c)(2)(iii)(B)).

Current California Law (Sec. 17201, 17271 and 24443)

In 1993, SB 671 conformed (for taxable and income years beginning on or after January 1, 1994) to the reduction in the deductible portion of business meals and entertainment expenses from 80 percent to 50 percent in conformity with the reduction in the Revenue Reconciliation Act of 1993.

New Federal Law (Sec. 274)

The Revenue Reconciliation Act of 1993 reduces the deductible portion of otherwise allowable business meals and entertainment expenses from 80 percent to 50 percent.

Effective Date of New Federal Law

The provision is effective for taxable years beginning after December 31, 1993.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

There is no revenue impact. California previously conformed to these provisions in SB 671.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13210

Section Title: Elimination Of Deduction For Club Membership Fees

Prior Federal Law (Sec. 274(a) and 274(e))

No deduction is permitted for club dues unless the taxpayer establishes that his or her use of the club was primarily for the furtherance of the taxpayer's trade or business and the specific expense was directly related to the active conduct of that trade or business.

Current California Law (Sec. 17269, 17271, 24343.2, and 24443)

For California purposes no expense that is otherwise deductible as a trade or business expense is deductible if it involves expenditures made at, or payments made to, a club that restricts membership based on age, sex, race, religion, color, ancestry, or national origin. Such expenses include, but are not limited to, club membership dues and assessments, food and beverage expenses, expenses for services furnished by a club, and reimbursements for salary adjustments to officers or employees for any of the above expenses. If a club that restricts membership (other than local chapters of national fraternal organizations) also holds a liquor license, it must also provide on each receipt given to a taxpayer the following printed statement: "The expenditures covered by this receipt are nondeductible for state income tax purposes or franchise tax purposes."

New Federal Law (Sec. 274(a))

No deduction is permitted for club dues. This rule applies to all types of clubs, including business, social, athletic, luncheon, and sporting clubs. Specific business expenses (e.g., meals) incurred at a club are deductible only to the extent they otherwise satisfy the standards for deductibility.

Effective Date of New Federal Law

Applies to amounts paid or incurred after December 31, 1993.

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be $10 million based on federal projections.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13211

Section Title: Disallowance of Deduction for Certain Employee Remuneration in Excess of $1,000,000

Prior Federal Law (Sec. 162)

An employer is allowed a deduction for reasonable salaries and other compensation. Whether compensation is reasonable is determined on a case-by-case basis. However, the reasonableness standard has been used primarily to limit payments by closely-held companies where nondeductible dividends may be disguised as deductible compensation.

Current California Law (Sec. 17201 and 24343.5)

California conforms to the deduction for reasonable salaries and other compensation.

New Federal Law (Sec. 162(m)(new))

Under the Revenue Reconciliation Act of 1993, in general, for purposes of the regular income tax and the alternative minimum tax, the otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation is limited to no more than $1 million per year.

Definition of publicly held corporation

For purposes of this provision, a corporation is treated as publicly held if the corporation has a class of common equity securities that is required to be registered under Section 12 of the Securities Exchange Act of 1934. In general, the Securities Exchange Act requires a corporation to register its common equity securities under Section 12 if (1) the securities are listed on a national securities exchange or (2) the corporation has $5 million or more of assets and 500 or more holders of such securities. A corporation is not considered publicly held under the provision if registration of its equity securities is voluntary. Such a voluntary registration might occur, for example, if a corporation that otherwise is not required to register its equity securities does so in order to take advantage of other procedures with regard to public offerings of debt securities.

Covered employees

Covered employees are defined by reference to the Securities and Exchange Commission (SEC) rules governing disclosure of executive compensation. Thus, with respect to a taxable year, a person is a covered employee if (1) the employee is the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year or (2) the employee's total compensation is required to be reported for the taxable year under the Securities Exchange Act of 1934 because the employee is one of the four highest compensated officers for the taxable year (other than the chief executive officer). If disclosure is required with respect to fewer than four executives (other than the chief executive officer) under the SEC rules, then only those for whom disclosure is required are covered employees.

Compensation subject to the deduction limitation

In general

Unless specifically excluded, the deduction limitation applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash. If an individual is a covered employee for a taxable year, the deduction limitation applies to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The $1 million cap is reduced by excess parachute payments (as defined in Sec. 280G) that are not deductible by the corporation.

The deduction limitation applies when the deduction would otherwise be taken. Thus, for example, in the case of a nonqualified stock option, the deduction is normally taken in the year the option is exercised, even though the option was granted with respect to services performed in a prior year.

Certain types of compensation are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million. The following types of compensation are not taken into account: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met; (3) payments to a tax-qualified retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross income (such as employer provided health benefits and miscellaneous fringe benefits (Sec. 132)); and (5) any remuneration payable under a written binding contract which was in effect on February 17, 1993, and all times thereafter before such remuneration was paid and which was not modified thereafter in any material respect before such remuneration was paid.

Commissions

In order to qualify for the exception for compensation paid in the form of commissions, the commission must be payable solely on account of income generated directly by the individual performance of the executive receiving such compensation. Thus, for example, compensation that equals a percentage of sales made by the executive qualifies for the exception. Remuneration does not fail to be attributable directly to the executive merely because the executive utilizes support services, such as secretarial or research services, in generating the income. However, if compensation is paid on account of broader performance standards, such as income produced by a business unit of the corporation, the compensation would not qualify for the exception because it is not paid with regard to income that is directly attributable to the individual executive.

Other performance-based compensation

In general. -- Compensation qualifies for the exception for performance-based compensation only if (1) it is paid solely on account of the attainment of one or more performance goals, (2) the performance goals are established by a compensation committee consisting solely of two or more outside directors, (3) the material terms under which the compensation is to be paid, including the performance goals, are disclosed to and approved by the shareholders in a separate vote prior to payment, and (4) prior to payment, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied.

Definition of performance-based compensation. -- Compensation (other than stock options or other stock appreciation rights) is not treated as paid solely on account of the attainment of one or more performance goals unless the compensation is paid to the particular executive pursuant to a preestablished objective performance formula or standard that precludes discretion. In general, this means that a third party with knowledge of the relevant performance results could calculate the amount to be paid to the executive. It is intended that what constitutes a performance goal be broadly defined, and include, for example, any objective performance standard that is applied to the individual executive, a business unit (e.g., a division or a line of business), or the corporation as a whole. Performance standards could include, for example, increases in stock price, market share, sales, or earnings per share.

Stock options or other stock appreciation rights generally are treated as meeting the exception for performance-based compensation, provided that the requirements for outside director and shareholder approval are met (without the need for certification that the performance standards have been met), because the amount of compensation attributable to the options or other rights received by the executive would be based solely on an increase in the corporation's stock price. In the case of stock options, it is intended that the directors may retain discretion as to the exact number of options that are granted to an executive, provided that the maximum number of options that the individual executive may receive during a specified period is predetermined.

Stock-based compensation is not treated as performance-based if it is dependent on factors other than corporate performance. For example, if a stock option is granted to an executive with an exercise price that is less than the current fair market value of the stock at the time of grant, then the executive would have the right to receive compensation on the exercise of the option even if the stock price decreases or stays the same. Thus, stock options that are granted with an exercise price that is less than the fair market value of the stock at the time of grant do not meet the requirements for performance-based compensation. Similarly, if the executive is otherwise protected from decreases in the value of the stock (such as through automatic repricing), the compensation is not performance-based.

In contrast to options or other stock appreciation rights, grants of restricted stock are not inherently performance-based because the executive may receive compensation even if the stock price decreases or stays the same. Thus, a grant of restricted stock is treated like cash compensation and does not satisfy the definition of performance-based compensation unless the grant or vesting of the restricted stock is based upon the attainment of a performance goal and otherwise satisfies the standards for performance-based compensation.

Compensation does not qualify for the performance-based exception if the executive has a right to receive the compensation notwithstanding the failure of (1) the compensation committee to certify attainment of the performance goal (or goals) or (2) the shareholders to approve the compensation.

DEFINITION OF OUTSIDE DIRECTORS. -- For purposes of the exception for performance-based compensation, a director is considered an outside director if he or she is not a current employee of the corporation (or related entities), is not a former employee of the corporation (or related entities) who is receiving compensation for prior services (other than benefits under a tax- qualified pension plan), was not an officer of the corporation (or related entities) at any time, and is not currently receiving compensation for personal services in any capacity (e.g., for services as a consultant) other than as a director.

SHAREHOLDER APPROVAL AND ADEQUATE DISCLOSURE. -- In order to meet the shareholder approval requirement, the material terms under which the compensation is to be paid must be disclosed and, after disclosure of such terms, the compensation must be approved by a majority of shares voting in a separate vote.

In the case of performance-based compensation paid pursuant to a plan (other than a stock option plan), the shareholder approval requirement generally is satisfied if the shareholders approve the specific terms of the plan, including the class of executives to which it applies. In the case of a stock option plan, the shareholders generally must approve the specific terms of the plan, the class of executives to which it applies, the option price (or formula under which the price is determined), and the maximum number of shares subject to option that can be awarded under the plan to any executive. Further shareholder approval of payments under a plan or grants of options is not required after the plan has been approved. Of course, if there are material changes to the plan, shareholder approval would have to be obtained again in order for the exception to apply to payments under the modified plan.

Under present law, in the case of a privately held company that becomes publicly held, the prospectus is subject to the rules similar to those applicable to publicly held companies. Thus, if there has been disclosure that would satisfy the rules described above, persons who buy stock in the publicly held company will be aware of existing compensation arrangements. No further shareholder approval is required of compensation arrangements existing prior to the time the company became public unless there is a material modification of such arrangements. It is intended that similar rules apply in the case of other business transactions.

Compensation payable under a written binding contract

Remuneration payable under a written binding contract which was in effect on February 17, 1993, and at all times thereafter before such remuneration was paid is not subject to the deduction limitation.

Compensation paid pursuant to a plan qualifies for this exception provided that the right to participate in the plan is part of a written binding contract with the covered employee in effect on February 17, 1993. For example, suppose a covered employee was hired by XYZ Corporation on January 17, 1993, and one of the terms of the written employment contract is that the executive is eligible to participate in the "XYZ Corporation Executive Deferred Compensation Plan" in accordance with the terms of the plan. Assume further that the terms of the plan provide for participation after 6 months of employment, amounts payable under the plan are not subject to discretion, and the corporation does not have the right to amend materially the plan or terminate the plan (except on a prospective basis before any services are performed with respect to the applicable period for which such compensation is to be paid). Provided that the other conditions of the binding contract exception are met (e.g., the plan itself is in writing), payments under the plan are grandfathered, even though the employee was not actually a participant in the plan on February 17, 1993.

The fact that a plan was in existence on February 17, 1993, is not by itself sufficient to qualify the plan for the exception for binding written contracts.

The exception for remuneration paid pursuant to a binding written contract ceases to apply to amounts paid after there has been a material modification to the terms of the contract. The exception does not apply to new contracts entered into or renewed after February 17, 1993. For purposes of this rule, any contract that is entered into on or before February 17, 1993, and that is renewed after such date is treated as a new contract entered into on the day the renewal takes effect. A contract that is terminable or cancelable unconditionally at will by either party to the contract without the consent of the other, or by both parties to the contract, is treated as a new contract entered into on the date any such termination or cancellation, if made, would be effective. However, a contract is not treated as so terminable or cancelable if it can be terminated or canceled only by terminating the employment relationship of the covered employee.

Effective Date of New Federal Law

Applies to compensation that is otherwise deductible by the corporation in a taxable year beginning on or after January 1, 1994.

Impact on California Revenue

The revenue gain for 1994-5 is estimate to be on the order of $2-3 million based on federal projections.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13212

Section Title: Reduction in Compensation Taken Into Account in Determining Contributions And Benefits Under Qualified Retirement Plans.

Prior Federal Law (Sec. 401)

The amount of a participant's compensation that can be taken into account under a tax-qualified pension plan is limited (Sec. 401(a)(17)). The limit applies for determining the amount of the employer's deduction for contributions to the plan as well as for determining the amount of the participant's benefits. The limit on includible compensation is $235,840 for 1993, and is adjusted annually for inflation. The limit in effect at the beginning of a plan year applies for the entire plan year.

Current California Law (Sec. 17501)

California is conformed, by reference, to contributions and benefits under qualified retirement plans.

New Federal Law (Sec. 401, 404, 408 and 505)

Under the Revenue Reconciliation Act of 1993, the limit on compensation taken into account under a qualified plan (Sec. 401(a)(17)) is reduced to $150,000. This limit is indexed for inflation in increments of $10,000. Corresponding changes also are made to other provisions (Secs. 404(l), 408(k)(3)(C), (6)(D)(ii), and (8), and 505(b)(7)) that take into account the Section 401(a)(17) limit.

Effective Date of New Federal Law

Applies to benefits accruing in plan years beginning after December 31, 1993. Benefits accrued prior to the effective date for compensation in excess of the reduced limit are grandfathered.

In the case of an eligible participant in a plan maintained by a State or local government, the limit on compensation taken into account is the greater of the limit under the Revenue Reconciliation Act of 1993 and the compensation allowed to be taken into account under the plan as in effect on July 1, 1993. For purposes of this rule, an eligible participant is an individual who first became a participant in the plan during a plan year beginning before the first plan year beginning after the earlier of: (1) the plan year in which the plan is amended to reflect the new law, or (2) December 31, 1995. This special rule does not apply unless the plan is amended to incorporate the dollar limit in effect under Section 401(a)(17) by reference, effective with respect to persons other than eligible participants for benefits accruing in plan years beginning after December 31, 1995 (or earlier if the plan amendment so provides). In the case of a plan maintained pursuant to one or more collective bargaining agreements ratified before August 10, 1993, the provision does not apply to contributions or benefits accruing under such agreements in plan years beginning before the earlier of (1) the latest of (a) January 1, 1994, (b) the date on which the last of such collective bargaining agreements terminates (without regard to any extension or modification on or after August 10, 1993), or (c) in the case of a plan maintained pursuant to collective bargaining under the Railway Labor Act, the date of execution of an extension or replacement of the last of such collective bargaining agreements in effect on August 10, 1993, or (2) January 1, 1997.

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be on the order of $20 million based on federal projections. This gain is considered to be a base-line revenue issue since taxpayers will assume continued state conformity and report the same deductions.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13213

Section Title: Modifications to Deduction for Moving Expenses

Prior Federal Law (Sec. 217)

An employee or self-employed individual may claim a deduction from gross income for certain expenses incurred as a result of moving to a new residence in connection with beginning work at a new location (Sec. 217). The deduction is not subject to the floor that generally limits a taxpayer's allowable miscellaneous itemized deductions to those amounts that exceed two percent of the taxpayer's adjusted gross income. Any amount received directly or indirectly by such individual as a reimbursement of moving expenses must be included in the taxpayer's gross income as compensation (Sec. 82). The taxpayer may offset this income by deducting the moving expenses that are deductible items under Section 217.

Deductible moving expenses are the expenses of transporting the taxpayer and members of the taxpayer's household, as well as household goods and personal effects, from the old residence to the new residence; the cost of meals and lodging enroute; the expenses for pre-move househunting trips; temporary living expenses for up to 30 days in the general location of the new job; and certain expenses related to either the sale of (or settlement of an unexpired lease) on the old residence, or the purchase of (or acquisition of a lease on) a new residence in the general location of the new job.

The moving expense deduction is subject to a number of limitations. A maximum of $1,500 can be deducted for pre-move househunting and temporary living expenses in the general location of the new job. A maximum of $3,000 (reduced by any deduction claimed for househunting or temporary living expenses) can be deducted for certain qualified expenses for the sale or purchase of a residence or settlement or acquisition of a lease. If both a husband and wife begin new jobs in the same general location, the move is treated as a single commencement of work. If a husband and wife file separate returns, the maximum deductible amounts available to each are one- half the amounts otherwise allowed.

Also, in order for a taxpayer to claim a moving expense deduction, the taxpayer's new principal place of work must be at least 35 miles farther from the taxpayer's former residence than was the taxpayer's former principal place of work (or at least 35 miles from the taxpayer's former residence, if the taxpayer has no former place of work).

Current California Law (Sec. 17201)

California is conformed, by reference, to the federal rules for the deductibility of moving expenses.

New Federal Law (Sec. 62, 67, 82, 132, 217, 1001, 1016 and 4977)

The Revenue Reconciliation Act of 1993 excludes from the definition of moving expenses: (1) the costs related to the sale of (or settlement of an unexpired lease on) the old residence, and the purchase of (or acquisition of a lease on) the new residence in the general location of the new job, (2) the costs of meals consumed while traveling and while living in temporary quarters near the new job, (3) the cost of pre-move househunting trips, and (4) the cost of temporary living expenses for up to 30 days in the general location of the new job. In addition, (1) the mileage limit is increased from 35 miles to 50 miles, (2) moving expenses not paid or reimbursed by the taxpayer's employer are allowable as a deduction in calculating adjusted gross income, and (3) moving expenses paid or reimbursed by the taxpayer's employer are excludable from gross income.

Definition of moving expenses

Moving expenses are defined as the reasonable costs of (1) moving household goods and personal effects from the former residence to the new residence and (2) traveling (including lodging during the period of travel) from the former residence to the new place of residence. Moving expenses do not include any expenses for meals.

Employer-paid moving expenses

Moving expenses are excludable from gross income and wages for income and employment tax purposes to the extent paid for by the taxpayer's employer (whether directly or through reimbursement). Moving expenses are not excludable if the taxpayer actually deducted the expenses in a prior taxable year.

Moving expenses not paid for by the employer

Moving expenses are deductible in computing adjusted gross income to the extent not paid for by the taxpayer's employer (whether directly or through reimbursement). Allowing such a deduction will treat taxpayers whose expenses are not paid for by their employer in a comparable manner to taxpayers whose moving expenses are paid for by their employer.

Effective Date of New Federal Law

The provision is effective for expenses incurred after December 31, 1993.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be on the order of $25 million based on federal projections.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13214

Section Title: Simplification of Individual Estimated Tax Safe Harbor Based on Last Year's Tax

Prior Federal Law (Sec. 6654(d), 6654(j), and 6654(l))

Under present law, an individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to:

(1) 100 percent of the tax shown on the return of the individual for the preceding year (the "100 percent of last year's liability safe harbor") or

(2) 90 percent of the tax shown on the return for the current year. Income tax withholding from wages is considered to be a payment of estimated taxes.

For estimated tax purposes, some trusts and estates are treated as individuals.

In addition, for taxable years beginning after 1991 and before 1997, a special rule provides that the 100 percent of last year's liability safe harbor generally is not available to a taxpayer that:

(1) has a modified adjusted gross income (AGI) in the current year that exceeds the taxpayer's AGI in the preceding year by more than $40,000 ($20,000 in the case of a separate return by a married individual) and

(2) has a modified AGI in excess of $75,000 in the current year ($37,500 in the case of a separate return by a married individual).

Current California Law (Sec. 19136)

California law conforms, in general, with federal rules relating to the payment of estimated tax by individuals. However, there are several significant differences:

The "required payment" is based upon 80% of the current year tax.

The "required payment" does not include alternative minimum tax.

Estimated payments are required, unless the tax due for the year is less than $100.

No penalty will be assessed if 80% of the current or prior year tax is subject to withholding.

No penalty will be assessed if 80% of the adjusted gross income consists of wages subject to withholding.

New Federal Law (Sec. 6654)

The special rule that denies the use of the 100 percent of last year's liability safe harbor is repealed for taxable years beginning after 1993. However, the 100 percent of last year's liability safe harbor is modified to be a 110 percent of last year's liability safe harbor for any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year. For this purpose, the AGI of a trust or an estate is determined pursuant to rules similar to those in Code Section 67(e).

For taxable years beginning after 1993, the Revenue Reconciliation Act of 1993 does not change the availability of (1) the 100 percent of last year's liability safe harbor for an individual with a preceding year AGI of $150,000 or less, or (2) the present-law rule that allows any individual to base estimated tax payments on 90 percent of the tax shown on the return for the current year.

Effective Date of New Federal Law

Applies to estimated tax payments applicable to taxable years beginning after December 31, 1993.

Impact on California Revenue

The revenue impact for 1994-5 is estimated to be a revenue loss on the order of $55 million and $5 million for 1995-6. Adopting the new federal safe harbor of 110% for certain taxpayers would result in reduced estimated tax payments relative to current state law.

B-I-B: Revenue Increases - Provisions Affecting Individuals - Other Provisions

Public Law: 103-66

Act Section: 13215

Section Title: Social Security And Tier 1 Railroad Retirement Benefits

Prior Federal Law (Sec. 86)

Under present law, a portion of Social Security and Railroad Retirement Tier 1 benefits is includible in gross income for taxpayers whose provisional incomes exceed a threshold amount. For purposes of this computation, a taxpayer's provisional income includes modified adjusted gross income (adjusted gross income plus tax-exempt interest plus certain foreign source income) plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit. The threshold amount is $25,000 for unmarried taxpayers, $32,000 for married taxpayers filing joint returns, and $0 for married taxpayers filing separate returns. A taxpayer is required to include in gross income the lesser of: (1) 50 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the applicable threshold amount.

A taxpayer may receive a lump-sum payment of benefits which includes benefits for one or more earlier years. In general, such payments are includible in total benefits in the year received. However, a taxpayer receiving these lump-sum benefits may elect to calculate their tax liability as if the benefits had been received in the year to which they are attributable (using the other elements of provisional income related to that year) and then include the appropriate amount in gross income for the current taxable year (in addition to the amount of benefits attributable to the current taxable year that are includible in gross income).

Proceeds from the income taxation of these benefits are credited quarterly to the Old-Age and Survivors Insurance Trust Fund, the Disability Insurance Trust Fund, or the Social Security Equivalent Benefit Account (of the Railroad Retirement system), as appropriate.

Current California Law (Sec. 17081)

California does not conform to federal law. The portion of Social Security or Railroad Retirement benefits included in federal income are subtracted on the California Adjustment Schedule on the California Income Tax Return before calculating the tax.

New Federal Law (Sec. 86)

The Revenue Reconciliation Act of 1993 creates a second tier of Social Security benefit inclusion in gross income. Present law applies to taxpayers with provisional income below $34,000 for unmarried individuals and $44,000 for married individuals filing joint returns. For taxpayers with provisional incomes above these higher thresholds, gross income includes the lesser of:

(1) 85 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit or

(2) the sum of:

(a) the smaller of (i) the amount included under present law; or (ii) $3,500 (for unmarried taxpayers) or $4,000 (for married taxpayers filing joint returns), plus,

(b) 85 percent of the excess of the taxpayer's provisional income over the applicable second-tier threshold amounts.

For married taxpayers filing separate returns, gross income includes the lesser of 85 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit or 85 percent of the taxpayer's provisional income.

For purposes of this computation, a taxpayer's provisional income (modified adjusted gross income plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit) is calculated in the same manner as under present law.

Revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the increased portion of benefits included in gross income will be transferred to the Medicare Hospital Insurance (HI) Trust Fund.

The Revenue Reconciliation Act of 1993 does not change the present-law election permitting a taxpayer to treat a lump-sum payment of benefits as received in the year to which benefits are attributable. Taxpayers electing this treatment compute the amount of benefits includible in gross income using the inclusion formula that applies to the taxable year to which the benefits are attributable. For example, if in 1994, a taxpayer receives a lump-sum payment of benefits that includes benefits attributable to 1992 and 1993, the amount of benefits attributable to 1992 and 1993 that is includible in gross income is determined using the present-law inclusion formula. The amount of benefits attributable to 1994 that is includible in gross income is computed using the inclusion formula in the Revenue Reconciliation Act of 1993.

Effective Date of New Federal Law

The provision is effective for taxable years beginning after December 31, 1993.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

These changes are not applicable since California has not previously conformed to federal law in this area.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13221

Section Title: Increase In Top Marginal Rate Under Section 11

Prior Federal Law (Sec. 11(b), 852(b), 1201(a), and 1445(e))

The highest marginal tax rate imposed on the taxable income of corporations is 34 percent. The maximum rate of tax on corporate net capital gain is also 34 percent. This rate applies to income in excess of $75,000. A 15-percent rate applies to taxable income not exceeding $50,000 and a 25-percent rate applies to taxable income over $50,000 and not exceeding $75,000.

A corporation with taxable income in excess of $100,000 is required to increase its tax liability by the lesser of 5 percent of the excess or $11,750. This increase in tax phases out the benefits of the 15- and 25-percent rates for corporations with taxable income between $100,000 and $335,000; a corporation with taxable income in excess of $335,000, in effect, pays tax at a flat 34-percent rate.

Current California Law (Sec. 18662, 23151, 23501, 24870, 24871, 24990, and 24990.5)

In general, California imposes a flat 9.3 percent franchise (or income) tax on the net income of a general corporation, except that, for a general corporation doing business in California, the tax imposed cannot be less than the minimum franchise tax ($800).

In the case of a bank or financial corporation, for income years beginning before January 1, 1995, the 9.3 percent tax is increased by an "in-lieu" rate of not less than 1.3 percent and is determined annually based upon the amount of personal property taxes and business license taxes paid by general corporations. For income years beginning on or after January 1, 1995, the "in-lieu" rate is 2.0 percent (statutory rate).

In the case of an "S" corporation, the tax rate is 2.5 percent (vs. 9.3). If the "S" corporation is also a financial corporation, the tax rate is 2.5 percent plus the in-lieu rate that applies to banks and financial corporations. For income years beginning on or after January 1, 1994, the rate is 1.5 percent rather than 2.5 percent. For financial "S" corporations, the rate, for income years beginning on or after January 1, 1994, is 1.5 percent plus the in-lieu rate that applies to banks and financial corporations.

New Federal Law (Sec. 11, 852, 1201 and 1445)

The Revenue Reconciliation Act of 1993 provides a new 35-percent marginal tax rate on corporate taxable income in excess of $10 million.

The maximum rate of tax on corporate net capital gains is also 35 percent.

A corporation with taxable income in excess of $15 million is required to increase its tax liability by the lesser of 3 percent of the excess or $100,000. This increase in tax recaptures the benefits of the 34-percent rate in a manner analogous to the recapture of the benefits of the 15- and 25-percent rates.

Effective Date of New Federal Law

Applies to taxable years beginning on or after January 1, 1993, except that existing law provisions relating to changes in tax rate shall apply. Thus, if any portion of the taxable year falls into 1993, a "blended rate" will be used to compute the tax liability.

Some taxpayers may be subject to the increased corporate tax rates with respect to a taxable year that has already ended.

Those taxpayers may have filed an application for an extension of the time for filing their corporate income tax returns pursuant to Section 6081. For such a filing to be valid, the taxpayer must remit "the amount of the properly estimated unpaid tax liability" (Treas. Reg. Sec. 1.6081-3). The Conference Report contains a statement that the conferees intend that the IRS apply this provision by computing that amount by reference to the law in effect on the date the application for the extension was filed.

Impact on California Revenue

These changes are not applicable since California has formulated its own tax rate structure.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13222

Section Title: Denial of Deduction for Lobbying Expenses

Prior Federal Law (Sec. 162(e), 170 and 6033)

Trade or business expenses

Taxpayers engaged in a trade or business generally are allowed a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on such trade or business (Sec. 162).

Present-law Section 162(e)(1) specifically provides a deduction for certain so-called "direct lobbying" expenses (including travel expenses, costs of preparing testimony, and a portion of dues) paid in carrying on a trade or business if such expenses are:

(1) in direct connection with appearances before, submissions of statements to, or sending communications to, the committees, or individual members, of Congress or of any legislative body of a State, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer, or

(2) in direct connection with communication of information between the taxpayer and an organization of which the taxpayer is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to such organization.

Section 162(e)(2) provides, however, that no deduction is allowed for any amount paid (whether by contribution, gift, or otherwise) for participation or intervention in any political campaign (i.e., "political campaign" expenses) or in connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections or referendums (i.e., "grass roots lobbying").

Treasury regulations further provide that if expenditures for lobbying purposes do not meet the requirements of Section 162(e)(1), such expenditures are not deductible as ordinary and necessary business expenses (Treas. Reg. Sec. 1.162-20(c)(1)). Thus, for example, lobbying of foreign government officials is not a deductible business expense under Section 162. Under the regulations, however, expenditures for institutional or "good will" advertising which keeps the taxpayer's name before the public are generally deductible, provided such expenditures are related to patronage the taxpayer might reasonably expect in the future (Treas. Reg. Sec. 1.162- 20(a)(2)).

Rules governing lobbying by tax-exempt organizations

Non-charitable tax-exempt organizations. -- Although most tax- exempt organizations other than charitable organizations (e.g., social welfare organizations and trade associations) generally may engage in unlimited lobbying efforts, some restrictions do exist. If political campaign or grass roots lobbying activities constitute a substantial part of the activities of an organization such as a labor union or a trade association, the portion of dues or other payments to the organization attributable to such activities cannot be deducted by the payor under Section 162.

Charitable organizations. -- A charitable organization otherwise described in Section 501(c)(3) is not entitled to tax-exempt status under that Section if a substantial part of its activities consists of "carrying on propaganda, or otherwise attempting, to influence legislation." There is no statutory definition under Section 501(c)(3) of "propaganda, or otherwise attempting, to influence legislation," but Treasury regulations provide that an organization will be regarded as "attempting to influence legislation" if it:

(1) contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation, or

(2) advocates the adoption or rejection of legislation (meaning action by Congress or another legislative body) (Treas. Reg. Sec. 1.501(c)(3)-1(c)(3)).

Conducting nonpartisan research (while not advocating legislative action) is not considered lobbying for purposes of the Section 501(c)(3) restriction, nor is seeking to protect the organization's own existence or responding to a governmental request for testimony.

An organization will not fail to meet the requirements of Section 501(c)(3) merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation (Treas. Reg. Sec. 1.501(c)(3)-1(c)(3)).

Similarly, a public charity making the Section 501(h) election can incur lobbying expenditures in an amount determined in accordance with a numeric formula set forth in Section 501(h) without jeopardizing its exempt status. However, if a public charity's lobbying expenditures (for either all lobbying or grass roots lobbying in particular) made during a taxable year exceed the amount allowable under the formula, an excise tax equal to 25 percent of the excess lobbying expenditures is imposed on the organization (Sec. 4911(a)). If the sum of the electing organization's lobbying expenditures during a four-year period exceeds 150 percent of the sum of the allowable amounts during that period, the organization loses its tax-exempt status under Section 501(c)(3) (Treas. Reg. Sec. 1.501(h)-3(b)).

Section 501(h) defines "lobbying expenditures" as "expenditures for the purpose of influencing legislation (as defined in Section 4911(d))." Section 4911(d) defines the term "influencing legislation" as --

"(A) any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof, and

(B) any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation."

However, Section 4911(d)(2) specifically EXCLUDES from the definition of "influencing legislation" the following activities:

(A) making available the results of nonpartisan analysis, study, or research;

(B) providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be;

(C) appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization;

(D) communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members, other than communications which directly encourage members to contact a legislative body in an attempt to influence legislation, or which directly encourage members to urge persons other than members to attempt to affect the opinions of the general public or to contact a legislative body in an attempt to influence legislation; and

(E) any communication with a government official or employee, other than --

(i) a communication with a member or employee of a legislative body (where such communication would otherwise constitute the influencing of legislation), or

(ii) a communication the principal purpose of which is to influence legislation.

For purposes of Section 4911, the term "legislation" is defined in Section 4911(e)(2) to include action with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure.

Treasury regulations provide that "legislation" for purposes of Section 4911(e)(2) includes action by legislative bodies but does not include action by "executive, judicial, or administrative bodies" (Treas. Reg. Sec. 56.4911-2(d)(3)).

Treasury regulations further provide that "administrative bodies" include school boards, housing authorities, sewer and water districts, zoning boards, and other similar Federal, State, or local special purpose bodies, whether elective or appointive (Treas. Reg. Sec. 56.4911- 2(d)(4)).

Private foundations. -- Private foundations (as distinguished from public charities) generally are subject to penalty excise taxes under Section 4945 if they engage in any direct or grass roots lobbying. For purposes of Section 4945, lobbying is defined in a manner similar to the definition under Section 4911(d).

Specifically, the Section 4945 penalty excise taxes do not apply to nonpartisan analysis, the provision of technical advice to a governmental body in response to a written request or lobbying before a legislative body with respect to a possible decision of such body which might affect the existence of the private foundation, its powers and duties, its tax-exempt status or the deduction of contributions to such foundation (Sec. 4945(e)).

Current California Law (Sec. 17201 and 24343)

California is fully conformed to federal law.

New Federal Law (Sec. 162, 170(f) and 6033)

General rule

Under the Revenue Reconciliation Act of 1993, no deduction is allowed under Section 162 for any amount paid or incurred in connection with (1) influencing Federal or State legislation or (2) any communication with certain covered Federal executive branch officials in an attempt to influence the official actions or positions of such officials.

The present-law rules disallowing business deductions for expenses of grass roots lobbying and participation in political campaigns will remain in effect. Similarly, the Conference Report contains a statement that the conferees intend that the present-law rule disallowing a deduction for lobbying of foreign governments will remain in effect.

Scope of general rule

The Revenue Reconciliation Act of 1993 applies to attempts to influence Federal or State legislation (as defined in present-law Section 4911(e)(2)) through communication with a member or employee of Congress or a State legislative body, or with any other government official or employee who may participate in the formulation of legislation. In addition, the Revenue Reconciliation Act of 1993 disallows a deduction for costs incurred in connection with any direct communication with a "covered executive branch official" in an attempt to influence the official actions or positions of such official. For this purpose, the term "covered executive branch official" means the following Federal officials:

(1) the president;

(2) the Vice President;

(3) an individual serving in a position in level I of the Executive Schedule (e.g., a Cabinet member) or any other individual designated by the President as having Cabinet-level status;

(4) any immediate deputy of an individual listed in (3) above;

(5) the two most senior-level officers of each agency within the Executive Office of the President; and

(6) any other officer or employee of the White House Office of the Executive Office of the President.

The Revenue Reconciliation Act of 1993 does not apply to attempts to influence legislative actions of a "local council or similar governing body." The Conference Report contains a statement that the conferees intend that any legislative body of a political subdivision of a State (e.g., a county or city council) be considered to be a "local council or similar governing body." Thus, attempts to influence the actions of such local bodies are not affected by the Revenue Reconciliation Act of 1993 and remain subject to present-law rules.

De minimis rule

The Revenue Reconciliation Act of 1993 provides a de minimis rule that exempts certain in-house lobbying expenditures from the general disallowance rule if a taxpayer's total amount of such expenditures for a taxable year does not exceed $2,000 (computed without taking into account general overhead costs otherwise allocable to lobbying).

For purposes of this rule, "in-house expenditures" means expenditures for lobbying (e.g., labor and materials costs) other than:

(1) payments to a person engaged in the trade or business of lobbying to conduct lobbying for the taxpayer (e.g., a payment to hire a professional lobbyist), and

(2) dues or other similar payments that are allocable to lobbying (e.g., association dues).

Thus, so long as a taxpayer's in-house lobbying expenditures do not exceed $2,000, such expenditures (including allocable overhead) may be disregarded and are not subject to the disallowance rule. However, payments made by a taxpayer to third-party lobbyists and dues payments allocable to lobbying are subject to the disallowance rules of the Revenue Reconciliation Act of 1993, regardless of whether or not the taxpayer's in-house expenses are exempted under the de minimis rule. In addition, the de minimis rule does not apply to expenses incurred for political activity, grass-roots lobbying, or foreign lobbying, which continue to be disallowed in their entirety under present-law rules.

Activities in support of lobbying

The Revenue Reconciliation Act of 1993 provides that any amount paid or incurred for research for, or preparation, planning, or coordination of, any lobbying activity subject to the general disallowance rule described above will be treated as paid or incurred in connection with such lobbying activity.

The Conference Report contains a statement that the conferees intend that the Secretary of the Treasury will provide guidance for distinguishing costs incurred in connection with (1) attempts to influence legislation from (2) mere monitoring of legislative activities where there is no attempt to influence the formulation or enactment of legislation. The Conference Report contains a statement that in cases where a taxpayer (or tax-exempt organization) monitors legislation and subsequently attempts to influence the formulation or enactment of the same (or similar) legislation, the conferees intend the costs of the monitoring activities generally will be treated as incurred "in connection with" nondeductible lobbying activity.

In determining the expenses incurred in connection with any direct communication with a covered executive branch official in an attempt to influence the official actions or positions of such official, only the costs attributable to the direct communication itself are nondeductible under the Revenue Reconciliation Act of 1993. Thus, for example, if a taxpayer works for an extended period to influence the actions of non-covered executive branch officials and, at the end of the project, a covered executive branch official approves the final decision through a separate communication with the taxpayer (e.g., a briefing or review of the matter), only the direct costs of the communication with the covered official would be disallowed (and not the costs of the work product from the earlier period). In contrast, if a taxpayer conducts research and analysis with a view toward directly communicating with a covered executive branch official, the costs of such research and analysis would be disallowed as attributable to the direct communication with the covered official.

Exceptions

The Revenue Reconciliation Act of 1993 does not include any of the statutory exceptions to the general disallowance rule that are contained in the House bill or Senate amendment. However, the Conference Report contains a statement that the conferees wish to clarify that (consistent with pre-1962 interpretations) any communication compelled by subpoena, or otherwise compelled by Federal or State law, does not constitute an "attempt to influence" legislation or an official's actions and, therefore, is not subject to the general disallowance rule.

Association dues

The Revenue Reconciliation Act of 1993 provides a flow-through rule to disallow a deduction for a portion of the membership dues (or similar payments) paid to a tax-exempt organization (other than a charitable organization) which engages in political or lobbying activities. Trade associations and similar organizations generally are required under the conference agreement to provide annual information disclosure (but not Form 1099 information reporting) to members estimating the portion of their dues allocable to lobbying. However, such disclosure is not required for an organization that:

(1) incurs only de minimis amounts of in-house lobbying expenditures;

(2) elects to pay a proxy tax on its lobbying expenditures incurred during the taxable year; or

(3) establishes pursuant to Treasury regulation (or other procedure) that substantially all of its dues monies are paid by members not entitled to deduct such dues in computing their taxable income.

De minimis rule

Under the Revenue Reconciliation Act of 1993, in-house lobbying expenses of $2,000 or less incurred by a tax-exempt organization during a taxable year are exempt from the general disallowance rule. This de minimis rule for tax-exempt organizations operates in the same manner as the de minimis rule for taxable businesses. That is, in determining whether the $2,000 de minimis exception applies, an organization is required to take into account any direct in-house expenses incurred for lobbying activities (i.e., labor and materials costs), but may disregard indirect expenses (i.e., a portion of general overhead) otherwise allocable to lobbying. Amounts paid to outside lobbyists (or as dues to another organization that lobbies) do not qualify for the de minimis exception.

Information disclosure

Tax-exempt organizations that engage in more than a de minimis amount of in-house lobbying (or make payments to third-party lobbyists or other associations that lobby) generally are required to meet certain disclosure requirements. First, the organization must disclose on its annual tax return both the total amount of its lobbying and political expenditures (as defined by the provisions of the conference agreement), and the total amount of dues (or similar payments) allocable to such expenditures. For this purpose, an organization's lobbying expenditures for the taxable year are allocated to the dues received during the taxable year. Any excess amount of lobbying expenditures is carried forward and allocated to dues received in the following taxable year.

An organization also is required to provide notice to each person paying dues (or similar payments) at the time of assessment or payment of such dues (or similar payments) of the portion of dues that the organization reasonably estimates will be allocable to the organization's lobbying expenditures during the year and that is, therefore, not deductible by the member. This estimate must be provided at the time of assessment or payment of such dues and be reasonably calculated to provide organization members with adequate notice of the nondeductible amount. If an organization's actual lobbying and political expenditures for a taxable year exceed the estimated allocable amount of such expenditures (either because of higher-than-anticipated lobbying expenses or lower-than-projected dues receipts), then the organization is required to pay a proxy tax on the excess amount or may seek permission to adjust the following year's notice of estimated expenditures.

Proxy tax

As an alternative to the disclosure requirements described above, an organization may elect to pay a proxy tax on the total amount of its lobbying expenditures (up to the amount of dues and other similar payments received by the organization) during the taxable year. If, for the current taxable year, an organization does not provide its members with reasonable notice of anticipated lobbying expenditures allocable to dues, then the organization is subject to the proxy tax on its aggregate lobbying expenditures for such year. Similarly, as stated above, an organization is required to pay a proxy tax on the amount by which its actual lobbying and political expenditures for a taxable year exceed the estimated allocable amount of such expenditures.

If the amount of lobbying expenditures exceeds the amount of dues and other similar payments for the taxable year, the proxy tax is imposed on an amount equal to the dues and similar payments; any excess lobbying expenditures are carried forward to the next taxable year. The proxy tax rate is equal to the highest corporate rate in effect for the taxable year. If an organization elects to pay the proxy tax rather than to provide any information disclosure to members, no portion of any dues or other payments made by members of the organization will be deemed non-deductible as the result of the organization's lobbying activities.

Waiver

If an organization establishes to the satisfaction of the Secretary of the Treasury (pursuant to regulation or other procedure) that substantially all of the dues monies it receives are paid by members who (even if lobbying were not involved) are not entitled to deduct their dues payments, then the organization is not subject to the disclosure requirements or the proxy tax.

The Conference Report contains a statement that the conferees intend that the waiver be available to any organization that receives 90 percent or more of its total dues (and similar payments) from persons not entitled to deduct such payments. The Revenue Reconciliation Act of 1993 contemplates that waivers will be provided pursuant to Treasury Department regulation or other Treasury Department procedure.

Penalties

Any organization that underreports the total amount of its lobbying expenses in any taxable year is required to pay the proxy tax (at the highest corporate tax rate) on any undisclosed or underreported amount. This tax may be imposed regardless of whether the organization has elected disclosure of lobbying expenses to its members or payment of the proxy tax for the taxable year. The Conference Report contains a statement that in such cases, the conferees intend that the proxy tax be imposed in addition to interest charges and any other penalties which may apply.

Charities

Under the Revenue Reconciliation Act of 1993, charitable organizations described in Section 501(c)(3) are not subject to the disclosure requirements (or proxy tax option) imposed on other tax-exempt organizations. However, the Revenue Reconciliation Act of 1993 does contain an anti-avoidance rule designed to prevent donors from using charities as a conduit to conduct lobbying activities, the costs of which would be nondeductible if conducted directly by the donor.

Therefore, the Revenue Reconciliation Act of 1993 provides that no deduction will be allowed under Sections 170 or 162 for amounts contributed to a charity that conducts lobbying activities, if:

(1) the charity's lobbying activities regard matters of direct financial interest to the donor's trade or business and

(2) a principal purpose of the contribution is to avoid the general disallowance rule that would apply if the contributor directly had conducted such lobbying activities.

The Conference Report contains a statement that the conferees intend that the determination regarding a principal purpose of the contribution for purposes of this rule be based on the facts and circumstances surrounding the contribution, including the existence of any formal or informal instructions relating to the charity's use of the contribution for lobbying efforts (including nonpartisan analysis), the temporal nexus between the making of the contribution and conduct of the lobbying activities, and any historical pattern of contributions by the donor to the charity.

Anti-cascading rule

The Revenue Reconciliation Act of 1993 contains a special provision to prevent a "cascading" of the lobbying disallowance rule. The purpose of the provision is to ensure that, when multiple parties are involved, the general lobbying disallowance rule results in the denial of a deduction at only one level. Thus, the Revenue Reconciliation Act of 1993 provides that, in the case of a taxpayer engaged in the trade or business of lobbying activities or a taxpayer who is an employee and receives employer reimbursements for lobbying expenses, the disallowance rule does not apply to expenditures of the taxpayer in conducting such activities directly on behalf of a client or employer.

Instead, the lobbying payments made by the client (or employer) to the lobbyist (or employee) are nondeductible under the general disallowance rule.

The anti-cascading rule applies where there is a direct, one-on-one relationship between the taxpayer and the entity conducting the lobbying activity, such as a client or employee relationship. The Conference Report contains a statement that the conferees intend that the anti-cascading rule will not apply to dues or other payments to taxable membership organizations which act to further the interests of their members rather than the interests of any one particular member. Such organizations are themselves subject to the general disallowance rule based on the amount of their lobbying expenditures, and dues payments to such organizations are not affected by the Revenue Reconciliation Act of 1993.

Effective Date of New Federal Law

Applies to amounts paid or incurred after December 31, 1993.

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be on the order of $6 million based on federal projections.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13223

Section Title: Mark-to-Market Accounting Method For Securities Dealers

Prior Federal Law (Sec. 475 (new) and 988(d))

A taxpayer that is a dealer in securities is required for Federal income tax purposes to maintain an inventory of securities held for sale to customers. A dealer in securities is allowed for Federal income tax purposes to determine (or value) the inventory of securities held for sale based on: (1) the cost of the securities; (2) the lower of the cost or market (LCM) value of the securities; or (3) the market value of the securities.

If the inventory of securities is determined based on cost, unrealized gains and losses with respect to the securities are not taken into account for Federal income tax purposes. If the inventory of securities is determined based on the LCM value, unrealized losses (but not unrealized gains) with respect to the securities are taken into account for Federal income tax purposes. If the inventory of securities is determined based on market value, both unrealized gains and losses with respect to the securities are taken into account for Federal income tax purposes.

Current California Law (Sec. 17078, 17551, 24651, 24701 and 24905)

California conforms to the federal rules relating to methods of accounting for inventories.

New Federal Law (Sec. 475 and 988)

The Revenue Reconciliation Act of 1993 provides two general rules (the "mark-to-market rules") that apply to certain securities that are held by a dealer in securities. First, any such security that is inventory in the hands of the dealer is required to be included in inventory at its fair market value.

Second, any such security that is not inventory in the hands of the dealer and that is held as of the close of any taxable year is treated as sold by the dealer for its fair market value on the last business day of the taxable year and any gain or loss is required to be taken into account by the dealer in determining gross income for that taxable year.

If gain or loss is taken into account with respect to a security by reason of the second mark-to-market rule, then the amount of gain or loss subsequently realized as a result of a sale, exchange, or other disposition of the security, or as a result of the application of the mark-to-market rules, is to be appropriately adjusted to reflect such gain or loss.

Character of gain or loss

Any gain or loss taken into account under the provision (or any gain or loss recognized with respect to a security that would be subject to the provision if held at the end of the year) generally is treated as ordinary gain or loss. This character rule does not apply to any gain or loss allocable to any period during which the security (1) is a hedge of a position, right to income, or a liability that is not subject to a mark-to-market rule under the provision, or (2) is held by the taxpayer other than in its capacity as a dealer in securities. In addition, the character rule does not apply to any security that is improperly identified by the taxpayer.

No inference is intended as to the character of any gain or loss recognized in taxable years prior to the enactment of this provision or any gain or loss recognized with respect to any property to which this character rule does not apply.

Definitions

A dealer in securities is defined as any taxpayer that either (1) regularly purchases securities from, or sells securities to, customers in the ordinary course of a trade or business, or (2) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

A security is: (1) any share of stock in a corporation; (2) any partnership or beneficial ownership interest in a widely-held or publicly-traded partnership or trust; (3) any note, bond, debenture, or other evidence of indebtedness; (4) any interest rate, currency, or equity notional principal contract (but not any other notional principal contract such as a notional principal contract that is based on the price of oil, wheat, or other commodity); and (5) any evidence of an interest in, or any derivative financial instrument in, any currency or in a security described in (1) through (4) above, including any option, forward contract, short position, or any similar financial instrument in such a security or currency.

In addition, a security is defined to include any position if: (1) the position is not a security described in the preceding paragraph; (2) the position is a hedge with respect to a security described in the preceding paragraph; and (3) before the close of the day on which the position was acquired or entered into (or such other time as the Treasury Department may specify in regulations), the position is clearly identified in the dealer's records as a hedge with respect to a security described in the preceding paragraph.

Exceptions to the mark-to-market rules

The exceptions to the mark-to-market rules do not apply unless, before the close of the day on which the security (including any evidence of indebtedness) is acquired, originated, or entered into (or such other time as the Treasury Department may specify in regulations), the security is clearly identified in the dealer's records as being described in one of the exceptions listed above. The Conference Report states that it is anticipated that the Treasury regulations will permit a financial institution that is treated as a dealer under the provision and that originates evidences of indebtedness in the ordinary course of a trade or business to identify such evidences of indebtedness as held for investment based on the accounting practices of the institution, but in no event later than the date that is 30 days after the date that any such evidence of indebtedness is originated. Where appropriate, Treasury regulations may provide similar identification rules for similar debt that is acquired, rather than originated, by a financial institution. Further, it is anticipated that the Treasury regulations will permit a dealer that enters into commitments to acquire mortgages to identify such commitments as being held for investment if the dealer acquires the mortgages and holds the mortgages as investments. It is anticipated that this identification of commitments to acquire mortgages will occur within an appropriate period after the acquisition of the mortgages, but in no event later than the date that is 30 days after the date that the mortgages are acquired.

Further, the Conference Report contains a statement that the conferees anticipate that the identification rules with respect to hedges will be applied in such a manner as to minimize the imposition of additional accounting burdens on dealers in securities. For example, it is understood that certain taxpayers engage in risk management strategies known as "global hedging." Under global hedging, the positions of one business unit of the taxpayer may be counter-balanced by positions of another separate business unit; any remaining net risk of the enterprise may then be hedged by entering into positions with unrelated third parties. The conferees understand that taxpayers engaging in global hedging often use accounting systems that clearly identify and treat the transactions entered into between the separate business units as if such transactions were entered into with unrelated third parties. The conferees anticipate that, subject to Treasury regulations, such an accounting system generally will provide adequate evidence for purposes of determining whether, and to what extent, a hedge with a third party is (1) a hedge of a security that is subject to the mark- to-market rules or (2) a hedge of a position, right to income, or a liability that is not subject to a mark-to-market rule, for purposes of applying the mark-to-market rules and the special character rule to a hedge with a third party.

Regulatory authority

The provision grants authority to the Treasury Department to promulgate regulations as may be necessary or appropriate to carry out the provisions of the bill. Such authority includes the authority to promulgate such regulations to prevent the use of year-end transfers, related persons, or other arrangements to take unintended advantage of the provisions of the bill. For instance, assume that an individual who is not subject to the mark-to-market rules contributes a security that has a built-in loss in the hands of the individual to a partnership that is subject to the mark-to-market rules. Consistent with rules that govern the treatment of a security that ceases to qualify for one of the exceptions to the mark-to-market rules in the hands of a single taxpayer, the Treasury regulations may provide that any loss that arose prior to the contribution to the partnership may not be taken into account by the partnership under the mark-to-market rules and that the suspended loss may be taken into account when the security is sold. Conversely, assume that prior to year end, a partnership that is subject to the mark-to-market rules distributes a security with a built-in gain to a partner that is not subject to such rules. Consistent with the authority to apply the mark-to-market rules at times other than at the end of a taxable year, the Treasury regulations may provide that the mark-to-market rules are to apply to the partnership with respect to such security as of the date of distribution.

Valuation of securities

The Revenue Reconciliation Act of 1993 does not provide any explicit rules mandating valuation methods that are required to be used for purposes of applying the mark-to-market rules. However, the Conference Report contains a statement that the conferees expect that the Treasury Department will authorize the use of valuation methods that will alleviate unnecessary compliance burdens for taxpayers and clearly reflect income for Federal income tax purposes.

Other hedging transactions

The Revenue Reconciliation Act of 1993 generally provides that any gain or loss with respect to hedges that are subject to the mark-to-market rules of the bill will be treated as ordinary gain or loss.

<u>Effective Date of New Federal Law</u>

In general, applies to taxable years ending on or after December 31, 1993.

A taxpayer that is required to change its method of accounting to comply with the requirements of the provision is treated as having initiated the change in method of accounting and as having received the consent of the Treasury Department to make such change. The net amount of the Section 481(a) adjustment is to be taken into account ratably over a 5-taxable year period beginning with the first taxable year ending on or after December 31, 1993.

Special rule for certain floor specialists and market makers

To the extent that a portion of the Section 481 (a) adjustment of a floor specialist or a market maker is attributable to the use of the

LIFO inventory method of accounting for any qualified security, such portion of the adjustment generally is taken into account ratably over a 15-taxable year period if the taxpayer (or any predecessor) had utilized the LIFO inventory method for that security for at least 5 years.

Impact on California Revenue

A "baseline" revenue gain of $10 million would occur regardless of conformity in that many companies would report in the same manner for state purposes. By conforming, an additional $10 million is estimated to result.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13224

Section Title: Clarification Of Treatment of Certain FSLIC Financial Assistance

Prior Federal Law (Act Language (noncode) affecting IRC Sec. 165, 166, 585, and 593)

A taxpayer may claim a deduction for a loss on the sale or other disposition of property only to the extent that the taxpayer's adjusted basis for the property exceeds the amount realized on the disposition and the loss is not compensated for by insurance or otherwise (Sec. 165 of the Code). In the case of a taxpayer on the specific charge-off method of accounting for bad debts, a deduction is allowable for the debt only to the extent that the debt becomes worthless and the taxpayer does not have a reasonable prospect of being reimbursed for the loss. If the taxpayer accounts for bad debts on the reserve method, the worthless portion of a debt is charged against the taxpayer's reserve for bad debts, potentially increasing the taxpayer's deduction for an addition to this reserve.

A special statutory tax rule, enacted in 1981, excluded from a thrift institution's income financial assistance received from the Federal Savings and Loan Insurance Corporation (FSLIC), and prohibited a reduction in the tax basis of the thrift institution's assets on account of the receipt of the assistance. Under the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), taxpayers generally were required to reduce certain tax attributed by one-half the amount of financial assistance received from the FSLIC pursuant to certain acquisitions of financially troubled thrift institutions occurring after December 31, 1988. These special rules were repealed by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), but still apply to transactions that occurred before May 10, 1989.

In September 1990, the Resolution Trust Corporation (RTC), in accordance with the requirements of FIRREA, issued a report to Congress and the Oversight Board of the RTC on certain FSLIC-assisted transactions (the "1988/89 FSLIC transactions"). The report recommended further study of the covered loss and other tax issues relating to these transactions. A March 4, 1991 Treasury Department report on tax issues relating to the 1988/89 FSLIC transactions concluded that deductions should not be allowed for losses that are reimbursed with exempt FSLIC assistance.

Current California Law (Sec. 24322)

California enacted legislation in 1988 (Ch. 1068, Stats. 1988) which contained legislative intent language that state law is identical with federal law provisions enacted in 1980 and 1986 for acquisitions or mergers which occurred on or before December 31, 1988. Thus, with respect to those acquisitions or mergers, gross income does not include FSLIC assistance payments and no reduction of the basis of assets is to be made on account of the receipt of FSLIC assistance. Also, California specified that no reduction to deductions would be made under Section 24425 by reason of the deduction being allocable to amounts excluded from gross income under this provision. This provision also contains a specific statutory rule that this exclusion from income does not apply to FSLIC assistance received after December 31, 1988 (except with respect to an acquisition or merger which occurred on or before December 31, 1988).

New Federal Law (Sec. Act Language (noncode) affecting IRC Sec. 165, 166, 585, and 593)

Noncodified language in the Revenue Reconciliation Act of 1993 provides that any FSLIC assistance with respect to any loss of principal, capital, or similar amount upon the disposition of an asset shall be taken into account as compensation for such loss for purposes of Section 165 of the Code. Any FSLIC assistance with respect to any debt shall be taken into account for purposes of determining whether such debt is worthless (or the extent to which such debt is worthless) and in determining the amount of any addition to a reserve for bad debts. For this purpose, FSLIC assistance means any assistance or right to assistance with respect to a domestic building and loan association (as defined in Section 7701(a)(19) of the Code without regard to subparagraph (C) thereof) under Section 406(f) of the National Housing Act or Section 21A of the Federal Home Loan Bank Act (or under any similar provision of law).

The provision does not apply to any financial assistance to which the amendments made by Section 1401(a) (3) of FIRREA apply.

No inference is intended as to prior law or as to the treatment of any item to which the Revenue Reconciliation Act of 1993 does not apply.

Effective Date of New Federal Law

In general, applies to financial assistance credited on or after March 4, 1991.

Impact on California Revenue

No apparent revenue impact.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13225

Section Title: Modification of Corporate Estimated Tax Rules

Prior Federal Law (Sec. 6655)

A corporation is subject to an addition to tax for any underpayment of estimated tax. For taxable years beginning after June 30, 1992, and before 1997, a corporation does not have an underpayment of estimated tax if it makes four equal timely estimated tax payments that total at least 97 percent of the tax liability shown on its return for the current taxable year. A corporation may estimate its current year tax liability prior to year-end by annualizing its income through the period ending with either the month or the quarter ending prior to the estimated tax payment due date. For taxable years beginning after 1996, the 97-percent requirement becomes a 91-percent requirement.

A corporation that is not a "large corporation" generally may avoid the addition to tax if it makes four timely estimated tax payments each equal to at least 25 percent of the tax liability shown on its return for the preceding taxable year. A large corporation may also use this rule with respect to its estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the three preceding taxable years.

Current California Law (Sec. 19004, 19010, 19023-19027, 19142-19151)

In 1992, AB 2425 and SB 617 modified California law, effective for income years beginning on or after January 1, 1993, to provide that a corporation is required to base its estimated tax payments on 95 percent of the tax show on its return for the current year.

New Federal Law (Sec. 6655)

A corporation is required to base its estimated tax payments on 100 percent (rather than 97 percent or 91 percent) of the tax shown on its return for the current year, whether such tax is determined on an actual or annualized basis. The Revenue Reconciliation Act of 1993 does not change the present-law availability of the 100 percent of last year's liability safe harbor for large or small corporations.

In addition, the Revenue Reconciliation Act of 1993 modifies the rules relating to income annualization for corporate estimated tax purposes. In general, the Act (1) adds a new, third set of periods over which corporations may elect to annualize income and (2) requires corporations to annually elect which of the three periods they will use to annualize income for the year.

Effective Date of New Federal Law

The provision is effective for taxable years beginning after December 31, 1993.

Impact on California Revenue

If California were to increase its required percentage from 95% to 100% effective with income years beginning after 12/31/94, the cash flow revenue gain in the first fiscal year, 1994-5, would be on the order of $17 million, decreasing to $10 million in 1995-6.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13226(a)

Section Title: Modifications of Discharge of Indebtedness Provisions

Prior Federal Law (Sec. 108)

Gross income generally includes cancellation of indebtedness (COD) income. Taxpayers in Title 11 cases and insolvent taxpayers, however, generally exclude COD income from gross income but reduce tax attributes by the amount of COD income. The amount of COD income that an insolvent taxpayer excludes cannot exceed the amount by which the taxpayer is insolvent.

The amount of COD income generally is the difference between the adjusted issue price of the debt being canceled and the amount of cash and the value of any property used to satisfy the debt. Thus, for purposes of determining the amount of COD income of a debtor corporation that transfers stock to a creditor in satisfaction of its indebtedness, the corporation generally is treated as realizing COD income equal to the excess of the adjusted issue price of the debt over the fair market value of the stock. However, if the debtor corporation is in a Title 11 case or is insolvent, the excess of the debt discharged over the fair market value of the transferred stock generally does not constitute COD income (the "stock-for-debt exception"). Thus, a corporate debtor that qualifies for the stock-for-debt exception is not required to reduce its tax attributes as a result of the debt discharge. The stock-for-debt exception does not apply to the issuance of certain preferred stock, nominal or token shares of stock, or stock issued to unsecured creditors on a relatively disproportionate basis. In the case of an insolvent debtor not in a Title 11 case, the exception applies only to the extent the debtor is insolvent.

Current California Law (Sec. 17131, 17144 and 24307)

California conforms, by reference, to federal law with certain modifications to substitute state credits for federal credits and to adjust for the difference in the rates of tax.

New Federal Law (Sec. 108)

The Revenue Reconciliation Act of 1993 repeals the stock-for-debt exception. Thus, regardless of whether a debtor corporation is insolvent or in bankruptcy, the transfer of its stock in satisfaction of its indebtedness is treated as if the corporation satisfied the indebtedness with an amount of money equal to the fair market value of the stock that had been transferred. Under the Act, an insolvent corporation or a corporation in a Title 11 case may exclude from income all or a portion of the COD income created by the transfer of its stock in satisfaction of indebtedness by reducing tax attributes.

In addition, the Act provides authority to the Treasury Department to promulgate such regulations as are necessary to coordinate the present-law rules regarding the acquisition by a corporation of its debt from a shareholder as a contribution to capital (Sec. 108 (e)(6)) with the repeal of the stock-for-debt exception.

A statement is contained in the report of the Conference Committee to clarify that no inference is intended with the enactment of this provision as to the treatment of any cancellation of the indebtedness of any entity that is not a corporation in exchange for an ownership or equity interest in such entity.

Effective Date of New Federal Law

The provision is effective for stock transferred after December 31, 1994, in satisfaction of any indebtedness, unless the transfer is in a Title 11 or similar case that was filed on or before December 31, 1993.

Impact on California Revenue

The revenue gain for the first full year, 1995-6, would probably be on the order of $2 million.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13226(b)

Section Title: Modifications of Discharge of Indebtedness Provisions

Prior Federal Law (Sec. 108)

The discharge of indebtedness generally gives rise to gross income to the debtor taxpayer. Present law provides exceptions to this general rule. Among the exceptions are rules providing that income from the discharge of indebtedness of the taxpayer is excluded from income if the discharge occurs in a Title 11 case, the discharge occurs when the taxpayer is insolvent, or in the case of certain farm indebtedness (Sec. 108 (a)(1)). The amount excluded from income under these exceptions is applied to reduce tax attributes of the taxpayer. The tax attributes reduced (in order) are (1) net operating losses and carryovers, (2) general business credit carryovers, (3) net capital losses and capital loss carryovers, (4) the basis of certain property of the taxpayer, and (5) foreign tax credit carryovers (Sec. 108(b)). The amount of the reduction is generally one dollar for each dollar excluded, except that the reduction in the case of credits is 33-1/3 cents for each dollar excluded.

Under present law, the passive loss rules limit deductions and credits from passive trade or business activities (Sec. 469). Deductions and credits suspended under these rules are carried forward to the next taxable year, and suspended losses are allowed in full when the taxpayer disposes of his entire interest in the passive activity to an unrelated person. Passive losses and credits are not tax attributes that are reduced under the rule relating to exclusion of discharge of indebtedness income.

Present law generally allows a minimum tax credit against a taxpayer's regular tax for the taxable year, for taxpayers who paid alternative minimum tax in a prior year (Sec. 53). The minimum tax credit generally is the excess of (1) the sum of the minimum tax imposed for all prior taxable years following 1986, over (2) the amount allowed as a minimum tax credit for those prior taxable years. Minimum tax credits are not tax attributes that are reduced under the rule relating to exclusion of discharge of indebtedness income.

Current California Law (Sec. 17131, 17144 and 24307)

California conforms, by reference, to federal law with certain modifications to substitute state credits for federal credits and to adjust for the difference in the rates of tax.

New Federal Law (Sec. 108)

The Revenue Reconciliation Act of 1993 adds additional tax attributes to the list of those that are reduced in the case of a discharge of indebtedness of the taxpayer that is excludable from income under section 108(a)(1). The attributes added are (1) minimum tax credits as of the beginning of the taxable year immediately after the taxable year of the discharge, and (2) passive activity loss and credit carryovers from the taxable year of the discharge. The amount of the reduction is generally one dollar for each dollar excluded, except that the reduction in the case of credits is 33-1/3 cents for each dollar excluded.

Effective Date of New Federal Law

The provision is effective for discharges of indebtedness in taxable years beginning after December 31, 1993.

Impact on California Revenue

The revenue gain for 1994-5 would probably be on the order of $1.5 million based on federal projections.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13227

Section Title: Limitation on Section 936 Credit

Prior Federal Law (Sec. 936)

Certain domestic corporations with business operations in the U.S. possessions may elect the use of the Section 936 credit which generally eliminates the U.S. tax on certain income related to their operations in the possessions. Income exempt from U.S. tax under this provision falls into two broad categories: business income, which in order to be exempt must be income treated as foreign source income derived from the active conduct of a trade or business within a U.S. possession or from the sale or exchange of substantially all of the assets that were used in such a trade or business; and investment income, which in order to be exempt must be derived from certain investments in the possessions or in certain Caribbean Basin countries. The investment income exempted under the provision is known as "qualified possession source investment income" (QPSII). For these and other purposes, income derived within a possession is encompassed within the term " foreign source income."

In order to qualify for the Section 936 credit, a domestic corporation must satisfy two requirements. Under one requirement, the corporation must be treated as deriving at least 75 percent of its gross income from the active conduct of a trade or business within a possession over a three-year period. Under the other requirement, the corporation must be treated as deriving at least 80 percent of its gross income from sources within a possession during that same three- year period.

Three alternative rules are provided that relate to allocating income from intangible property between a domestic corporation that elects the Section 936 credit (a "possession corporation") and its U.S. shareholders. The general rule is to prohibit the possession corporation from earning any return on intangible property. A possession corporation can instead elect to subject itself to one of two alternative rules, if it satisfies certain conditions.

One such rule is referred to as the "cost sharing method." Use of this method requires the possession corporation to pay to the appropriate members of its affiliated group of corporations (including foreign affiliates) an amount which represents its current share of the costs of the research and development expenses of the group. The Code determines that share to be the greater of (1) the total amount of the group's research and development expenses concerning the possession corporation's product area, multiplied by 110 percent of the proportion of its sales as compared to total product area sales of the group; or (2) the amount of the royalty payment or inclusion that would be required under Sections 367(d) and 482 with respect to intangible assets which the possession corporation is treated as owning under the cost sharing method, were the possession corporation a foreign corporation (whether or not the intangible assets actually are transferred to the possession corporation). By making this cost sharing payment, the possession corporation becomes entitled to treat its income as including a return from certain intangibles, primarily manufacturing intangibles, associated with the products it manufactures in the possessions.

The alternative elective rule for allocating income from intangible property between a possession corporation and its U.S. affiliates is a "profit split" approach. This method generally permits allocation to the possession corporation of 50 percent of the affiliated group of U.S. corporations' combined taxable income derived from sales of products which are manufactured in a possession.

Dividends paid by a possession corporation to a U.S. shareholder may qualify for the deduction for dividends received from a domestic corporation (Sec. 243). In cases where at least 80 percent of the stock of the possession corporation is owned by a single domestic corporation, the possession corporation's possession source income generally may be distributed without the parent corporation incurring any regular U.S. income tax.

Taxes paid or accrued by possession corporations to foreign countries or possessions on income which is taken into account in determining the Section 936 credit are neither deductible nor allowable for purposes of determining the foreign tax credit.

A possession corporation's income, the tax on which may be offset by the Section 936 credit, is not included in the alternative minimum taxable income (AMTI) of the possession corporation. Thus, possession corporations generally are exempt not only from the regular income tax but also from the alternative minimum tax (AMT). Moreover, dividends received by a U.S. corporation from a possession corporation generally do not constitute AMTI of the recipient corporation since, as described above, they may be offset by the dividends received deduction.

For purposes of determining a U.S. corporation's adjustment to AMTI based on adjusted current earnings (ACE), a deduction is allowed for certain dividends received. Specifically, a deduction is available (to the extent allowed under Section 243 or 245) for any dividend that qualifies for the 100-percent dividends received deduction for regular tax purposes, or that is received from a 20-percent owned corporation (as defined in Section 243 (c) (2)), but only to the extent that the dividend is attributable to income of the paying corporation which is subject to U.S. income tax determined after the application of Section 936. A dividend received by a U.S. corporation from its wholly owned possession corporation subsidiary generally does not qualify for the dividends received deduction, and thus increases the ACE of the recipient, because the income of the possession corporation typically is not taxed by the United States due to the Section 936 credit.

For purposes of computing the foreign tax credit, the Code provides that dividends paid by a possession corporation to an affiliated U.S.

corporation are characterized as foreign source income. Unless an exception applies, dividends are subject to the separate foreign tax credit limitation for passive income. In computing the AMT foreign tax credit, 75 percent of any withholding or income tax paid to a possession with respect to dividends received from a possession corporation generally is treated as a creditable tax. Moreover for such computation, taxes paid to a possession by a possession corporation are deemed to be such a withholding tax for this purpose to the extent they would be treated as taxes paid by the recipient of the dividend under rules similar to the rules of the indirect foreign tax credit (Secs. 78 and 902) if the possession corporation were a foreign corporation.

Cover over of excise taxes

U.S. excise taxes generally do not apply within the possessions, including Puerto Rico and the U.S. Virgin Islands. Articles that are manufactured in the possessions and brought into the United States for use or consumption are taxed on entry into the United States in the same manner as if the articles were imported from a foreign country. Thus, under general excise tax principles, these articles are taxed at the same rate that applies to domestically produced like articles.

In the case of excise taxes on certain articles brought into the United States from Puerto Rico and the Virgin Islands, and in the case of the distilled spirits excise tax on rum, a portion of the revenues is transferred ("covered over") to the treasuries of Puerto Rico and the Virgin Islands. This revenue cover over is significantly limited, both as to the taxes included and as to activities (e.g., manufacturing value added) that must occur in the possession from which the article comes as a condition of payment.

<u>Current California Law (Sec. 23051.5(b)(2))</u>

California does not conform to the Possessions Tax Credit (Sec. 936) or the federal Foreign Tax Credit. Instead, California uses the Uniform Division of Income for Tax Purposes Act (UDITPA) to determine the income subject to California tax under the world wide combined reporting method for those corporations doing business in more than one state. Under the Water's Edge Method, Section 936 corporations are "outside" the Water's Edge, and their income and factors are not used in determining the income subject to California tax.

<u>New Federal Law (Sec. 936)</u>

In general, the Revenue Reconciliation Act of 1993 provides that the Section 936 credit allowed to a possession corporation for a taxable year against U.S. tax on its active business income (i.e., income derived from the active conduct of a possession-based business, or from the sale of assets used in such a business) is determined as under present law, but is subject to either of two alternative limitations. One alternative limitation is based on factors that reflect the corporation's economic activity in the possessions (the "economic-activity limitation"), and the other limitation is based on a statutorily defined percentage of the Section 936 credit that would be allowable under present-law rules (the "percentage limitation").

The option of which alternative limitation to apply is left to the taxpayer. In order to utilize the percentage limitation, however, a corporation must elect use of that limitation for its first taxable year beginning after 1993 for which it claims a Section 936 credit. Once a possession corporation elects to use the percentage limitation, it must continue to compute its Section 936 credit under that limitation for all subsequent taxable years unless the election is revoked.

The Act includes a consistency rule that requires all affiliated possession corporations to utilize the same alternative limitation. If, for example, a possession corporation that uses the percentage limitation becomes a member of an affiliated group that contains a second possession corporation that uses the economic-activity limitation, then the first corporation will be deemed to have revoked its election to use the percentage limitation. The determination whether a possession corporation is part of an affiliated group generally is made by reference to the consolidated return rules, except that stock owned by attribution under the rules of Section 1563 is treated as owned directly, and the exclusions from the definition of "includible corporation" listed in Section 1504(b) are disregarded. The Act also grants authority to the Treasury Secretary to develop rules that would treat 2 or more possession corporations as members of the same affiliated group to prevent avoidance of the consistency rule through deconsolidation or other means.

Excise tax cover over

The Revenue Reconciliation Act of 1993 also temporarily increases the cover over of rum excise taxes to Puerto Rico and the Virgin Islands from $10.50 per proof gallon to $11.30 per proof gallon. This increased cover over rate applies in the case of distilled spirits brought into the United States during the five year period beginning on October 1, 1993.

Effective Date of New Federal Law

The provision generally is effective for taxable years beginning after December 31, 1993.

Impact on California Revenue

Not applicable, since California has not conformed to prior federal law.

B-II: Revenue Increases - Provisions Affecting Business

Public Law: 103-66

Act Section: 13228

Section Title: Modification to Limitation on Deduction for Certain Interest

Prior Federal Law (Sec. 163(j))

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 in the hands of the recipient. In certain cases where interest is paid by a corporation to a related person, and no U.S. tax is imposed on the recipient's interest income, the so-called "earnings stripping rules" in the Code provide for denial of interest deductions by the corporate payor to the extent that the corporation's net interest expenses exceed 50 percent of its adjusted taxable income. The disallowance is limited by, among other things, the amount of tax-exempt interest paid to related persons. The disallowance does not apply to interest on debt with a fixed term which was issued on or before July 10, 1989, or which was issued after that date pursuant to certain written binding contracts in effect on that date.

The Treasury is authorized to provide such regulations as may be appropriate to prevent the avoidance of the purposes of this provision, including regulations that would disallow deductions for interest paid to unrelated creditors in certain cases: for example, certain cases that involve guarantees of the debt by parties related to the debtor. The legislative history accompanying the bill enacting the provision, however, indicates an intent that such regulations not generally subject third-party interest to disallowance whenever a guarantee is given in the ordinary course. The legislative history further indicates an expectation that any such regulations would not apply to debt outstanding prior to notice of the rule if and to the extent that the regulations depart from positions the Service and Treasury might properly take under analogous principles of law that would recharacterize guaranteed debt as equity.

To date, Treasury has promulgated no proposed or final regulations that interpret the application of the earnings stripping rules to third-party debt that is guaranteed by a person related to the debtor.

Current California Law (Sec. 24344)

California conforms, by reference, to the federal rules but makes modifications to the rules for corporations which determine the income subject to tax under the formulary apportionment rules. For those corporations, deductible interest is, in general, limited to interest income subject to formula apportionment, plus the excess of the balance of interest expense over the amount of interest and dividend income not subject to formula apportionment.

New Federal Law (Sec. 163(j))

Under the Revenue Reconciliation Act of 1993, interest is subject to disallowance under the earnings stripping rules without regard to whether it is interest on a fixed-term obligation issued before, on, or after July 10, 1989. Under the Act, interest paid on a loan from an unrelated party generally is treated under the earnings stripping rules as interest paid to a related person with respect to which no U.S. tax is imposed if no gross-basis U.S. income tax is imposed on the interest (whether or not the interest recipient is subject to net-basis U.S. income tax with respect to that interest), a related person guaranteed the loan, and the related person is either exempt from U.S. Federal income tax or is a foreign person. Exceptions apply where the taxpayer controls the guarantor, and in cases, identified by regulation, where the interest on the indebtedness would have been subject to net basis tax if the interest had been paid to the guarantor. Except as provided in regulations, a guarantee is defined to include any arrangement under which a person directly or indirectly assures, on a conditional or unconditional basis, the payment of another's obligation.

Effective Date of New Federal Law

The provision applies to any interest paid or accrued in taxable years beginning after December 31, 1993.

Impact on California Revenue

The revenue gain for 1994-5 is estimated to be on the order of $3 million under the Bank & Corporation Tax law.

B-III-A: Revenue Increases - Foreign Tax Provisions - Current Taxation Of Certain Earnings Of Controlled Foreign Corporations

Public Law: 103-66

Act Section: 13231-13233

Section Title: Current Taxation Of Certain Earnings Of Controlled Foreign Corporations

Prior Federal Law (Sec. 951(a), 956A (new), 959(a), 959(b), 959(c), 959(f), 1296(a), 1296(b), 1297(b), and 1297(d))

U.S. citizens and residents and U.S. corporations (collectively, "U.S. persons") generally are taxed currently by the United States on their worldwide income. Income earned by a foreign corporation, the stock of which is owned in whole or in part by U.S. persons, generally is not taxed by the United States until the foreign corporation repatriates those earnings by payment to its U.S. stockholders.

Under the controlled foreign corporation rules of Subpart F, a controlled foreign corporation is defined generally as any foreign corporation if U.S. persons own more than 50 percent of the corporation's stock, taking into account only so-called "U.S. shareholders": namely, those U.S. persons that own (directly, indirectly or by attribution) at least 10 percent of its voting stock. A "U.S. shareholder" may be taxed by the United States on certain earnings of the controlled foreign corporation that have not been distributed by the foreign corporation to the U.S. shareholder. Such "inclusions" of undistributed controlled foreign corporation earnings are triggered by two different provisions of the controlled foreign corporation rules.

Under one such provision, a U.S. shareholder is taxed currently on its proportionate share of the controlled foreign corporation's "subpart F income" earned during the taxable year. Subpart F income typically is foreign income that is relatively movable from one taxing jurisdiction to another and that is subject to low rates of foreign tax relative to the U.S. rate. Excluded from the definition of subpart F income, among other things, are certain dividends and interest received from a related corporation organized and operated in the same foreign country as the recipient.

The other provision taxing U.S. shareholders on undistributed controlled foreign corporation earnings applies to the controlled foreign corporation's total current or accumulated earnings (other than subpart F income), to the extent of an increase in the amount of those earnings invested by the controlled foreign corporation in certain U.S. property (as defined in Code Section 956).

Earnings and profits of a controlled foreign corporation that have been included in the income of U.S. shareholders before actual repatriation are not taxed again when such earnings are in fact distributed to the U.S. shareholders.

If any foreign corporation (including a controlled foreign corporation) is a "passive foreign investment company" (PFIC), U.S. persons (including 10-percent "U.S. shareholders") that own any stock in the PFIC may be subject to one of two other sets of operating rules that eliminate or reduce the benefits of deferral. A PFIC generally is defined as any foreign corporation if (1) 75 percent or more of its gross income for the taxable year consists of passive income, or (2) 50 percent or more of its assets consist of passive assets, defined as assets that produce, or are held for the production of, passive income.

A U.S. person owning PFIC stock may elect to include currently in gross income its share of the PFIC's total earnings. A nonelecting U.S. person owning PFIC stock pays no current tax on the PFIC's undistributed income. However, when realizing income earned through ownership of PFIC stock (such as certain dividends distributed by the PFIC or capital gains from selling PFIC stock), the nonelecting U.S. person may pay an additional interest charge.

Current California Law (Sec. 18151, 23051.5(b)(2), 24995 and 25110)

In general, California does not conform to the federal rules relating to controlled foreign corporations. However, for California water's edge purposes, a controlled foreign corporation (CFC) is required to be included in the water's edge combined report if the CFC has Subpart F income defined in Section 952 of the Internal Revenue Code.

With respect to a "water's-edge election" the income subject to California apportionment is generally the income for federal purposes of the corporations within the electing group, including the income under the federal rules for Subpart F income. However, California does not follow the FSC and DISC exemption/deferral of income provisions. All of the income and factors of FSCs and DISCs are required to be included in the water's-edge combined report.

New Federal Law (Sec. 951(a), 956A (new), 959(a), 959(b), 959(c), 959(f), 1296(a), 1296(b), 1297(b), and 1297(d))

The Revenue Reconciliation Act of 1993 limits the availability of deferral of U.S. tax on certain earnings of controlled foreign corporations. The Revenue Reconciliation Act of 1993 generally requires current inclusions in the income of U.S. shareholders of a controlled foreign corporation to the extent of the corporation's accumulated earnings invested in excess passive assets. The Revenue Reconciliation Act of 1993 also conforms the treatment of earnings of controlled foreign corporations invested in U.S. property to the new rules for earnings invested in excess passive assets, and makes related modifications to other rules applicable to controlled foreign corporations and PFICs.

Effective Date of New Federal Law

In general, applies to taxable years beginning after September 30, 1993.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Impact on California Revenue

No revenue impact.

B-III-B: Revenue Increases - Foreign Tax Provisions - Allocation of Research and Experimental Expenditures

Public Law: 103-66

Act Section: 13234

Section Title: Allocation of Research and Experimental Expenditures

Prior Federal Law (Sec. 864(f))

In order that the foreign tax credit will offset only the U.S. tax on the taxpayer's foreign source taxable income, a limitation formula is prescribed in the Code. To compute the limitations, it is necessary to divide the taxable income of a U.S. person into U.S. source taxable income, foreign source taxable income in each applicable separate limitation category, and foreign source taxable income in the general foreign tax credit limitation category.

Foreign source taxable income in any limitation category equals foreign source gross income in that category less the expenses, losses and other deductions properly apportioned or allocated to that income. A Treasury regulation issued in 1977 describes methods for allocating expenses between U.S. and foreign source income, including rules for the allocation of research expenses.

Since 1981, however, the research expense allocation regulation has been subject to a series of statutory temporary suspensions and modifications. The most recent temporary statutory provision (set forth in Code Section 864(f)) was applicable generally for the first six months of the first taxable year beginning after August 1, 1991. For this purpose, total research expenses for the year were deemed to be incurred evenly throughout the year.

For expenses deemed paid or incurred during the first six months of the year referred to above (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source), 64 percent of U.S. incurred research expenses were allocated to U.S. source income, and 64 percent of foreign incurred research expenses were allocated to foreign source income. The remainder of research expenses were allocated and apportioned either on the basis of sales or gross income, but subject to the condition that if income-based apportionment was used, the amount apportioned to foreign source income could have been no less than 30 percent of the amount that would have been apportioned to foreign source income had the sales method been used.

The Treasury has announced that during what would ordinarily be an 18-month period following the six-month period referred to above -- that is, the last six months of the taxpayer's first taxable year beginning after August 1, 1991 and the immediately succeeding taxable year -- taxpayers may continue to allocate research expenses in accordance with the method set forth in Code Section 864(f). In granting the transitional period, Treasury stated that the transitional method was not intended to suggest any particular views about the proper allocation and apportionment of research expenses. Rather, Treasury stated, the transition method was intended solely to provide taxpayers with transitional relief and to minimize audit controversy and facilitate business planning during the conduct of the regulatory review.

Current California Law (Sec. 25110)

California has not directly conformed to federal provisions relating to allocation of research and experimental expenditures between foreign source income and United States source income.

California does not generally conform to the federal rules for sourcing the income of foreign corporations, except for certain foreign corporations doing business in California. Those corporations, which have a water's-edge election in force, are required to use federal rules to determine United States source income, including the rules for foreign corporations.

With respect to banks and corporations, other than water's-edge corporations, California uses the world wide combined reporting (WWCR) method of determining the income subject to California tax.

New Federal Law (Sec. 864(f))

The Revenue Reconciliation Act of 1993 temporarily adopts for one year the research allocation rules of Code Section 864(f), except that the portion of research expense automatically allocated and apportioned to income sourced in the place of performance of the research is 50 percent, rather than 64 percent. Thus, for research expense other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source, 50 percent of U.S.-incurred research expense is allocated and apportioned to U.S. source income, and 50 percent of foreign-incurred research expense is allocated and apportioned to foreign source income. The remaining research expense is allocated and apportioned either on the basis of sales or gross income, but subject to the condition that if income-based apportionment is used, the amount apportioned to foreign source income can be no less than 30 percent of the amount that would have been apportioned to foreign source income had the sales method been used.

The Revenue Reconciliation Act of 1993 provides regulatory authority for the implementation of certain adjustments regarding Section 936 companies. In addition, the Revenue Reconciliation Act of 1993 authorizes the Treasury to prescribe such regulations as may be appropriate to carry out the purposes of this provision, including regulations relating to the determination of whether research activities are conducted inside or outside the United States and making such adjustments as may be appropriate in the case of cost sharing arrangements and contract research.

Effective Date of New Federal Law

The provisions of the Revenue Reconciliation Act of 1993 apply to the first taxable year (beginning on or before August 1, 1994) following the taxpayer's last taxable year to which Rev. Proc. 92-56 applies, or would have applied had the taxpayer elected the benefits of that Revenue Procedure.

Impact on California Revenue

The total impact for certain water's-edge electors is estimated to be a rather minor revenue gain.

B-III-C: Revenue Increases - Foreign Tax Provisions - Other Provisions

Public Law: 103-66

Act Section: 13235

Section Title: Eliminate Working Capital Exception for Foreign Oil and Gas and Shipping Income

Prior Federal Law (Sec. 904(d), 907, and 954)

Foreign tax credit limitations are computed separately for certain categories of foreign source income, including passive income, high withholding tax interest, financial services income, shipping income, dividends from each noncontrolled section 902 corporation, certain distributions from DISCs and FSCs, certain types of income earned by a FSC, and all other (i.e., "overall basket" or "general basket") income. Passive income generally includes income which is of a kind which would be foreign personal holding company income as defined under Section 954(c) (e.g., interest and dividends) and typically is not subject to high levels of foreign tax. The separate limitation for passive income generally prevents the cross-crediting of high foreign taxes on income which falls in the general basket against the residual U.S. tax on passive income.

The separate foreign tax credit limitation for passive income was enacted in 1986 and replaced the prior law separate foreign tax credit limitation for passive interest income. Prior law excluded from the passive interest separate limitation category interest derived from any transaction which is directly related to the active conduct by the taxpayer of a trade or business in a foreign country. Regulations under prior law expressly treated certain types of interest on working capital as interest derived from a transaction which is directly related to the active conduct of a trade or business. No such general working capital exception exists under the passive income definition as established in 1986. As a result of the interaction of the Code and Treasury regulations originally developed prior to 1987, however, the working capital exception has been retained for the oil and gas and shipping industries.

Special limitations on credits for foreign extraction taxes and taxes on foreign oil related income

In addition to the foreign tax credit limitations that apply to all creditable foreign taxes, a special limitation is placed on foreign income taxes on foreign oil and gas extraction income (FOGEI). Under this special limitation, amounts claimed as taxes paid on FOGEI of a U.S. corporation qualify as creditable taxes (if they otherwise so qualify) only to the extent they do not exceed the product of the highest marginal U.S. tax rate on corporations (presently 34 percent) multiplied by such extraction income. Foreign taxes paid in excess of that amount on such income are, in generaal neither creditable nor deductible (unless a credit carryover provision applies).

A similar special limitation may apply to foreign taxes paid on foreign oil related income (FORI) in certain cases where that type of income is subjected to a materially greater level of tax by a foreign jurisdiction than non oil and gas income generally would be. Under this limitation, a portion of the foreign taxes on FORI may be deductible, but not creditable.

As previously described, regulations issued prior to 1986 and still effective define FOGEI and FORI to include interest on working capital related to extraction or oil related activities, as the case may be. Thus, under current regulations, FOGEI and FORI include what generally would be considered as passive income for foreign tax credit limitation purposes.

Current California Law (Sec. 18685, 19164, and 25935)

California has not directly conformed to these federal provisions; however, certain foreign corporations doing business in California, which have a water's-edge election in force, are required to use federal rules to determine United States source income.

New Federal Law (Sec. 904(d), 907, and 954

The Revenue Reconciliation Act of 1993 prevents the cross-crediting of foreign taxes on FOGEI, FORI, and shipping income by placing certain passive income related to oil and gas and shipping operations in the passive category for foreign tax credit limitation purposes. In addition, the Revenue Reconciliation Act of 1993 excludes certain passive income related to foreign oil and gas extraction or other foreign oil related activities from the computation of the FOGEI and FORI foreign tax credit limitations. However, for purposes of applying Section 954(f), dividends and interest received from a foreign corporation in respect of which taxes are deemed paid under section 902 are classified as foreign base company shipping income (as under present law) to the extent attributable to foreign base company shipping income. Similarly, the Conference agreement contains a statement that the conferees intend that dividends and interest received from a foreign corporation in respect of which taxes are deemed paid under Section 902 are classified as FOGEI or FORI, respectively, to the extent attributable to FOGEI or FORI.

Foreign tax credit separate limitations

With respect to the separate foreign tax credit limitation for passive income, the Revenue Reconciliation Act of 1993 eliminates the present-law exclusion of FOGEI from the definition of passive income. Thus, if a taxpayer has gross income that falls within the definition of passive income under section 904, and also satisfies the definition of FOGEI under section 907, the income would be treated as passive income in determining the taxpayer's foreign tax credit.

In addition, the Revenue Reconciliation Act of 1993 amends the present-law rule applicable to income which by definition qualifies both as foreign personal holding company income under Section 954(c) and as foreign base company oil related income under Section 954(g). The Revenue Reconciliation Act of 1993 provides that such income is to be treated as foreign personal holding company income. As such, the income generally would be passive income for foreign tax credit purposes.

Likewise, the Revenue Reconciliation Act of 1993 specifies that dividend or interest income that by definition qualifies as both foreign personal holding company income and foreign base company shipping income is to be treated as foreign personal holding company income. Thus, for foreign tax credit purposes, the income would fall in the passive basket rather than in the separate basket for shipping income.

Special FOGEI and FORI limitations

The Revenue Reconciliation Act of 1993 provides that the term "foreign oil and gas extraction income" does not include any dividend or interest income which is passive income as defined for foreign tax credit limitation purposes. Since, as discussed above, the Revenue Reconciliation Act of 1993 treats gross interest income on working capital related to foreign oil and gas extraction activities, for example, as passive income, such income is not considered FOGEI for purposes of computing the special limitation for foreign taxes paid on FOGEI.

In addition, the Revenue Reconciliation Act of 1993 specifies that the term "foreign oil related income" does not include any dividend or interest income which is passive income as defined under the foreign tax credit provisions. As a result, for example, gross interest income on working capital related to activities which generate foreign oil related income would not be treated as FORI for purposes of computing the special limitation for foreign taxes paid on FORI.

Effective Date of New Federal Law

Applies to income earned in taxable years beginning after December 31, 1992.

Impact on California Revenue

No apparent revenue impact as California does not provide for a foreign tax credit.

B-III-C: Revenue Increases - Foreign Tax Provisions - Other Provisions

Public Law: 103-66

Act Section: 13236

Section Title: Modifications Of Accuracy-Related Penalty

Prior Federal Law (Sec. 6662(e) and 6662(h))

A "substantial" valuation misstatement may result in a penalty of 20 percent of the understatement of tax attributable to the substantial valuation misstatement (Sec. 6662(a) and (b) (2)). The penalty for a "gross" valuation misstatement is 40 percent of the tax understatement (Sec. 6662(h)). No valuation misstatement penalty is imposed if it is shown that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (see Sec. 6664(c)).

There is a substantial valuation misstatement if, among other things, the net Section 482 transfer price adjustment for the taxable year exceeds $10 million. The analogous "gross valuation misstatement" involves a net Section 482 transfer price adjustment of $20 million. The net Section 482 transfer price adjustment is the net increase in taxable income for a taxable year resulting from adjustments under Section 482 in the price for any property or services (or use of property). However, a net increase in taxable income attributable to a price redetermination is disregarded, for this purpose, if it is shown that there was a reasonable cause for the taxpayer's determination of the price, and that the taxpayer acted in good faith with respect to the price.

Current California Law (Sec. 18685, 19164, and 25935)

California has not directly conformed to either federal provisions relating to the transfer pricing rules in Section 482 which are used to measure the income of commonly controlled foreign and United States corporations or the penalty for substantial valuation misstatement.

California does not generally conform to the federal rules for sourcing the income of foreign corporations, except for certain foreign corporations doing business in California. Those corporations, which have a water's-edge election in force, are required to use federal rules to determine United States source income, including the rules for foreign corporations. With respect to banks and corporations, other than water's-edge corporations, California uses the world wide combined reporting (WWCR) method of determining the income subject to California tax.

New Federal Law (Sec. 6662(e) and 6662(h))

Under the Revenue Reconciliation Act of 1993, the threshold amount of net Section 482 transfer price adjustment that generally would trigger a substantial valuation misstatement penalty is lowered to $5,000,000. In addition, the term substantial valuation misstatement is expanded to include a case where the net Section 482 transfer price adjustment for the taxable year exceeds 10 percent of the taxpayer's gross receipts. The term gross valuation misstatement includes a case where the net Section 482 transfer price adjustment exceeds 20 percent of gross receipts.

In measuring the amount of a taxpayer's net Section 482 transfer price adjustment, a net increase in taxable income attributable to a price redetermination is disregarded under the provision only if the taxpayer satisfies certain statutory requirements.

The taxpayer would meet the requirements if it established that each of three criteria were met. First, the taxpayer would have to establish that the price it used was determined under a pricing method specified in the Section 482 regulations. Second, the taxpayer would have to establish that it applied the method reasonably. (In order for the application of the method to have been reasonable, it is intended that any procedural or other requirements imposed under the regulations must have been observed. For example, if certain adjustments required under a particular method were not made, the application of that method would not be reasonable.) Third, the taxpayer would have to establish that it had documentation, in existence as of the time of filing its original return, setting forth the reasonable determination of the price as described above, which documentation the taxpayer provides to the IRS within 30 days of a request for it.

Alternatively, the taxpayer would meet the requirements if it established that none of the methods specified in the Section 482 regulations was likely to result in a price that would clearly reflect income, that it used another method which was likely to result in such a price, and that it had documentation, in existence as of the time of filing its original return, setting forth the determination of the price and establishing the foregoing requirements, which documentation the taxpayer provides to the IRS within 30 days of a request for it.

Under the Revenue Reconciliation Act of 1993, it is intended that the application of any method would not be considered reasonable if the taxpayer became aware prior to filing its tax return that such application more likely than not did not lead to an arm's length result. In the case of a valuation misstatement due to a net Section 482 transfer price adjustment, no penalty would be excused for reasonable cause and good faith unless the above requirements were met.

The Conference Report contains a statement that the conferees note that under the Revenue Reconciliation Act of 1993, a taxpayer that does not apply a pricing method specified in the Section 482 regulations may nevertheless have its net increase in taxable income attributable to a Section 482 adjustment disregarded in determining the amount of its net Section 482 transfer price adjustment, but in order to do so the taxpayer must establish (among other things) that none of the methods specified in the Section 482 regulations was likely to result in a price that would clearly reflect income. With respect to those various types of transactions that generally are not the subject of any pricing methods specified in the Section 482 regulations, the conferees wish to clarify that to meet the above requirement, it will be necessary simply to establish that the transaction is of a type for which no methods are specified in the Section 482 regulations.

Effective Date of New Federal Law

Applies to taxable years beginning after December 31, 1993.

Impact on California Revenue

Federal impact estimates are very minor. The amount of an equivalent state penalty and the frequency of use in transfer-pricing cases involving waters-edge corporations are unknown.

B-III-C: Revenue Increases - Foreign Tax Provisions - Other Provisions

Public Law: 103-66

Act Section: 13237

Section Title: Denial Of Portfolio Interest Exemption For Contingent Interest

Prior Federal Law (Sec. 871(h), 881(c), 1441(c), and 1442(a))

Deductibility of interest

As a general rule, a deduction is allowed for all interest paid or accrued on indebtedness. Whether a financial instrument is treated as debt for Federal income tax purposes depends on the facts of the particular case. Under existing law, an instrument may qualify as debt even if it provides the holder with significant equity participation rights. For example, the IRS has ruled that in certain cases, contingent interest paid on a shared appreciation mortgage loan used to finance the purchase of a personal residence may be deductible by a cash basis payor. As another example, contingent interest based on a share of the borrower's profits has been determined to be deductible in certain cases.

Interest received by foreign persons

The Internal Revenue Code provides that U.S. source interest income earned by a nonresident alien individual or a foreign corporation that is not effectively connected with the conduct of a U.S. trade or business generally is subject to a gross-basis 30- percent withholding tax. A significant statutory exemption from that tax applies to so-called "portfolio interest" received by foreign persons.

Portfolio interest generally is defined as any U.S. source interest (including original issue discount) that is not effectively connected with the conduct of a trade or business and (1) is paid on an obligation that satisfies certain registration requirements or specified exceptions thereto, and (2) is not received by a 10-percent owner of the issuer of the obligation, taking into account shares owned by attribution.

Foreign-investment in U.S. real property -- shared appreciation debt

A foreign person's gain on the disposition of a U.S. real property interest (USRPI) is treated as income that is effectively connected with the conduct of a U.S. trade or business, and thus is subject to net-basis tax at ordinary U.S. income tax rates pursuant to the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). USRPIs include interests (other than solely as a creditor) in (1) real property, and (2) domestic corporations that are U.S. real property holding corporations (USRPHCs).

Whether a financial instrument is considered debt under any provisions of the Code does not determine whether it constitutes an "interest solely as a creditor" for purposes of FIRPTA. Regulations provide that an interest in real property other than an interest solely as a creditor includes any right to share in the appreciation in the value of, or in the gross or net proceeds or profits generated by, the real property. Similarly, an interest in an entity (such as a USRPHC) other than an interest solely as a creditor includes any right to share in the appreciation in the value of an interest in, or the assets of, the entity, or a right to share in the gross or net proceeds or profits derived by, the entity.

Regulations further provide that amounts otherwise treated for tax purposes as principal and interest payments on debt obligations of all kinds (including obligations that are interests other than solely as a creditor) do not give rise to gain or loss that is subject to U.S. tax under FIRPTA. Thus, a foreign owner of a note that pays interest contingent on appreciation in U.S. real property incurs U.S. income tax if he disposes of the note, but may not incur U.S. income tax if he holds the note and receives interest payments under its terms.

Estate tax treatment of portfolio obligations

As a general rule, estate tax is imposed on the transfer of the taxable estate of every decedent nonresident who was not a citizen of the United States. For this purpose, the value of the gross estate of such a decedent that is subject to tax is that part of his or her gross estate which at the time of death (or as provided in Section 2104(b)) is situated in the United States. Certain types of property are specifically excluded by statute from a nonresident decedent's gross estate. One type of property granted such an exclusion is a debt obligation if any interest thereon would be eligible for the exemption from income tax for portfolio interest were such interest received by the decedent at the time of his or her death, determined without regard to whether a statement has been received that the beneficial owner of the obligation is not a United States person.

Current California Law (Sec. 17201 and 24344)

California conforms to the federal law rules for the deduction of interest expenses. However, California specifically does not conform to the federal treatment of non-resident aliens. Instead, California has its own rules for sourcing income and deductions of nonresident individuals, estates and trusts.

California does not generally conform to the rules for foreign corporations, except for certain foreign corporations doing business in California that make a water's-edge election. Those corporations, which have a water's-edge election in force, are required to use federal rules to determine United States source income, including the rules for foreign corporations. With respect to banks and corporations, other than water's-edge corporations, California uses the world wide combined reporting (WWCR) method of determining the income subject to California tax.

California does not impose an estate tax, other than a "pick-up" tax. The "pick-up" tax imposes a California estate tax equal to the maximum amount of the federal credit for state estate taxes paid.

New Federal Law (Sec. 871(h), 881(c), 1441(c), and 1442(a))

The Revenue Reconciliation Act of 1993 makes the portfolio interest exemption inapplicable to certain contingent interest income received by foreign persons. In the case of an instrument on which a foreign holder earns both contingent and non-contingent interest, denial of the portfolio interest exemption applies only to the portion of the interest which is contingent interest.

Under the Revenue Reconciliation Act of 1993, contingent interest includes interest determined by reference to any of the following attributes of the debtor or any related person: receipts, sales, or other cash flow; income or profits; or changes in the value of property. In addition, contingent interest includes interest determined by reference to any dividend, partnership distribution, or similar payment made by the debtor or a related person.

The Revenue Reconciliation Act of 1993 provides a number of exceptions to the general definition of contingent interest as detailed above. Under one such exception, interest is not considered contingent solely because the timing of the interest or any related principal payment is subject to a contingency. In addition, portfolio interest treatment is not denied solely because the interest is paid with respect to nonrecourse or limited recourse indebtedness. Interest also is not denied portfolio treatment under the Revenue Reconciliation Act of 1993 if all or substantially all of it is determined by reference to certain other amounts of interest that is NOT described as contingent above (or by reference to the principal amount of indebtedness on which such other interest is paid). In determining whether all or substantially all of an amount of interest payable on a debt obligation is computed by reference to another amount of interest that is not contingent interest, other factors that affect the amount of interest payable on the debt obligation, but which are not contingencies as contemplated by the provision, are not taken into account.

Another of the Revenue Reconciliation Act of 1993's exceptions provides that interest is not denied portfolio treatment solely because the debtor or a related person enters into a hedging transaction to reduce the risk of interest rate or currency fluctuations with respect to such interest. Interest also is not denied portfolio treatment if it is determined by reference to changes in the value of (or any index of the value of) actively traded property other than a USRPI. For this purpose, the term "property" includes stock, and the term "actively traded" has the meaning given to that term under Section 1052(d) of the Code. In general, portfolio treatment also is not denied if the interest is determined by reference to the yield (or any index of the yield) on such actively traded property. However, this exception for interest contingent on the yield of actively traded property does not apply if the property is a debt instrument that itself pays contingent interest as described above, or the actively traded property is stock or other property that represents a beneficial interest in the debtor or a related person.

The Revenue Reconciliation Act of 1993 provides that application of the provision may be extended to any type of contingent interest not specifically described in the bill, if identified by the Treasury Secretary in regulations. The Secretary is granted authority to issue such regulations to supplement the statutory description of contingent interest in order to address cases where a denial of the portfolio interest exemption is necessary or appropriate to prevent avoidance of U.S. income tax. The Revenue Reconciliation Act of 1993 additionally provides that the Secretary may by regulation exempt any type of interest from denial, under the bill, of portfolio treatment.

The provision is not intended to override existing treaties that reduce or eliminate U.S. withholding tax on interest paid to foreign persons.

The Conference Report contains a statement that the conferees wish to clarify the treatment under the provision of a debt instrument with a minimum non-contingent interest rate. For example, assume that the interest rate on a debt instrument is stated as the greater of either of two amounts -- 6% of the principal amount or 10% of gross profits. In such a case, only the gross-profits-based interest is contingent interest. The conferees wish to clarify that with respect to such an instrument, only the excess of the contingent amount, if any, over the minimum fixed interest amount is disqualified from portfolio interest treatment.

The Revenue Reconciliation Act of 1993 provides that, for purposes of determining the gross estate of a nonresident noncitizen decedent subject to the estate tax, a special rule applies to debt instruments that provide for both contingent and noncontingent interest. Under the conference agreement, an appropriate portion of the value of such an instrument, as determined in a manner prescribed by the Secretary of the Treasury, is treated as property within the United States and, thus, is included in the decedent's gross estate. Until rules are issued that provide guidance as to the proper method for determining the appropriate portion of such an instrument that is treated as situated in the United States, the conferees intend that taxpayers be permitted to use any reasonable method for making such determination.

Effective Date of New Federal Law

Applies to interest received after December 31, 1993. It does not apply, however, to any interest paid or accrued with respect to any indebtedness with a fixed term that was issued on or before April 7, 1993, or was issued after such date pursuant to a written binding contract in effect on such date and at all times thereafter before such indebtedness was issued.

The estate tax provision is effective for decedents dying after December 31, 1993. The provision does not apply to any obligation with a fixed term that was issued on or before April 7, 1993, or was issued after such date pursuant to a written binding contract in effect on such date and at all times thereafter before it was issued.

Impact on California Revenue

Not applicable.

B-III-C: Revenue Increases - Foreign Tax Provisions - Other Provisions

Public Law: 103-66

Act Section: 13238

Section Title: Regulations Dealing With Conduit Arrangements

Prior Federal Law (Sec. 7701(l)(new))

The tax treatment of a transaction may depend on the identity of the parties to the transaction. For example, a loan by a controlled foreign corporation to a related U.S. borrower is treated as an investment in U.S. property under Code Section 956, and as such, may result in an inclusion of income to U.S. shareholders of the foreign corporation. On the other hand, an income inclusion to the U.S. shareholders of the foreign corporation would not have resulted had the loan been made by the same foreign corporation to an unrelated foreign borrower.

Under the Code, payments of interest by U.S. persons to related foreign persons may be subject to 30-percent gross-basis withholding tax. On the other hand, no such tax applies to payments by U.S. persons to unrelated foreign persons of so-called portfolio interest. Under treaties, payments of interest by U.S. persons to related foreign persons who are resident in the treaty country may be subject to little or no U.S. gross-basis tax. By contrast, if the related recipient of interest is resident in a country with respect to which no U.S. income tax treaty is in force, the 30-percent gross-basis tax would be imposed.

Courts have stated that the incidence of taxation depends upon the substance of a transaction as a whole. In certain cases, courts have recharacterized transactions in order to impose tax consistent with this principle. For example, where three parties have engaged in a chain of transactions, the courts have at times ignored the "middle" party as a mere "conduit," and imposed tax as if a single transaction had been carried out between the parties at the ends of the chain.

In Aiken Industries. Inc. v. Commissioner, the Tax Court recharacterized an interest payment by a U.S. person on its note held by a related treaty-country resident, which in turn had a precisely matching obligation to a related non-treaty-country resident, as a payment directly by the U.S. person to the non-treaty-country resident. The transaction in its recharacterized form resulted in a loss of the treaty protection that would otherwise have applied on the payment of interest by the U.S. person to the treaty-country resident, and thus caused the interest payment to give rise to 30- percent U.S. tax.

The IRS has taken the position that it will apply a similar result in cases where the back-to-back related party debt obligations are less closely matched than those in Aiken Industries, so long as the intermediary entity does not obtain complete dominion and control over the interest payments. The IRS has taken an analogous position where an unrelated financial intermediary is interposed between the two related parties as lender to one and borrower from the other, as long as the intermediary would not have made or maintained the loan on the same terms without the corresponding borrowing. In a recent technical advice memorandum, the IRS has taken the position that interest payments by a U.S. company to a related, treaty-protected financial intermediary may be treated as payments by the U.S. company directly to the foreign parent of the financial intermediary even though the matching payments from the intermediary to the parent are not interest payments, but rather are dividends.

Current California Law (Sec. 18685, 19164, and 25935)

California has not directly conformed to federal provisions relating to treaty protected financial intermediaries and which are used to measure the income of commonly controlled foreign and United States corporations and thus, no gross-basis withholding tax is required.

With respect to a "water's-edge election" the income subject to California apportionment is generally the income for federal purposes of the corporations within the electing group, including the income under the federal rules for Subpart F income. However, California does not follow the FSC and DISC exemption/deferral of income provisions. All of the income and factors of FSCs and DISCs are required to be included in the water's-edge combined report.

New Federal Law (Sec. 7701(l)(new))

The Revenue Reconciliation Act of 1993 authorizes the Treasury Secretary to promulgate regulations that set forth rules for recharacterizing any multiple-party financing transaction as a transaction directly among any two or more of such parties where the Secretary determines that such recharacterization is appropriate to prevent avoidance of any tax imposed by the Internal Revenue Code.

A statement is contained in the Conference Report that it is intended that the provision apply not solely to back-to-back loan transactions, but also to other financing transactions. The Conference Report states that for example, it would be within the proper scope of the provision for the Secretary to issue regulations dealing with multiple-party transactions involving debt guarantees or equity investments.

Effective Date of New Federal Law

The provision is effective August 10, 1993.

Impact on California Revenue

Regulations have yet to be issued. The possible impact on certain water's-edge filers cannot be evaluated at this time.

B-III-C: Revenue Increases - Foreign Tax Provisions - Other Provisions

Public Law: 103-66

Act Section: 13239

Section Title: Treatment Of Export of Certain Softwood Logs

Prior Federal Law (Sec. 861-865, 921-927, 951-964 and 991-996)

Rules for sourcing income

Subject to significant exceptions, income from the sale of personal property generally is sourced on the basis of the residence of the seller. One set of exceptions apply to sales of inventory property. Income derived from the purchase of inventory property within the United States and its sale outside the United States constitutes foreign source income. Similarly, income derived from the purchase of inventory property outside the United States and its sale within the United States constitutes domestic source income. Income attributable to the marketing of inventory property by U.S. residents in other cases may also have its source determined to be the place of sale. For this purpose, the place of sale generally is the place where title to the property passes to the purchaser (the "title passage" rule).

Income derived from the manufacture of products in the United States and their sale elsewhere is treated as having a divided source. Under Treasury regulations, 50 percent of such income generally is attributed to the place of production (in this case, the United States), and 50 percent of the income is attributed to marketing activities and is sourced on the basis of the place of sale (determined under the title passage rule). Under certain circumstances, the division of the income between production and marketing activities must be made on the basis of an independent factory or production price, rather than on a 50-50 basis, where a taxpayer sells part of its output to wholly independent distributors or other selling concerns in such a way as to establish fairly the independent factory or production price unaffected by considerations of tax liability (Treas. Reg. Sec. 1.863-3(b)(2), Example (1); Notice 89-10, 1989-4 I.R.B. 10).

Income earned by foreign corporations

The United States exerts jurisdiction to tax all income, whether derived in the United States or elsewhere, of U.S. citizens, residents, and corporations. By contrast, the United States taxes nonresident aliens and foreign corporations only on income with a sufficient nexus to the United States. In the case of income earned by a U.S.-owned foreign corporation, generally no U.S. tax is imposed until that income is distributed to the U.S. shareholders as a dividend.

When a U.S.-controlled foreign corporation earns so-called "Subpart F income," the United States generally taxes the corporation's 10-percent U.S. shareholders currently on their pro-rata share of that income regardless of whether the income is actually distributed currently to the shareholders. Included among the types of income deemed distributed (generally referred to as "Subpart F income") is foreign base company sales income.

Certain Subpart F income derived by a controlled foreign corporation that is an export trade corporation (ETC) from certain export activities is exempt from current taxation. Under this exemption, the Subpart F income of an ETC is reduced by certain amounts that constitute export trade income (as defined in Section 971). No foreign corporation may qualify as an ETC unless it has so qualified generally since 1971.

Foreign sales corporations

A portion of the income of an eligible foreign sales corporation (FSC) that is generated from export property is exempt from Federal income tax. If the income earned by the FSC is determined under special administrative pricing rules, then the exempt foreign trade income generally is 15/23 of the foreign trade income the FSC derives from the transaction. In addition, a domestic corporation is allowed a 100-percent dividends-received deduction for dividends distributed from the FSC out of earnings attributable to certain foreign trade income. Thus, generally no corporate level tax is imposed on a portion of the income from exports of a FSC.

Foreign trade income is defined as the gross income of a FSC attributable to foreign trading gross receipts. Foreign trade income includes both the profits earned by the FSC itself from exports and commissions earned by the FSC from products exported by others and services related thereto. In general, the term foreign trading gross receipts means the gross receipts of a FSC which are attributable to the export of certain goods and services. Foreign trading gross receipts are the gross receipts of the FSC that are attributable to the following types of transactions: the sale of export property, the lease or rental of export property, services related and subsidiary to the sale or lease of export property, engineering and architectural services, and export management services.

Export property, for purposes of the FSC rules, is defined as property that is (1) manufactured, produced, grown, or extracted in the United States by a person other than a FSC, (2) held primarily for sale, lease, or rental, in the ordinary conduct of a trade or business by, or to, a FSC, for direct use, consumption, or disposition outside the United States, and (3) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States.

Domestic International Sales Corporations

Prior law provided for a system of tax deferral for corporations known as Domestic International Sales Corporations, or "DISCs," and their shareholders. Under this system, the profits of a DISC were not taxed to the DISC but were taxed to the shareholders of the DISC when distributed or deemed distributed to them. Each year, a DISC was deemed to have distributed a portion of its income, thereby subjecting that income to current taxation in its shareholders' hands. Federal income tax could generally be deferred on the remaining portion of the DISC's taxable income until the income was actually distributed to the shareholders.

Under current law, a DISC is permitted to continue to defer income attributable to $10 million or less of qualified export receipts. However, unlike the prior-law DISC rules, an interest charge is imposed on the shareholders of the DISC. The amount of the interest is based on the tax otherwise due on the deferred income computed as if the income were distributed. Taxable income of the DISC attributable to qualified export receipts that exceed $10 million is deemed distributed to the DISC's shareholders.

To qualify for DISC treatment, at least 95 percent of a domestic corporation's gross receipts must consist of qualified export receipts. In general, qualified export receipts are receipts, including commission receipts, derived from the sale or lease for use outside the United States of export property, or from the furnishing of services related or subsidiary to the sale or lease of export property. Export property must be manufactured, produced, grown, or extracted in the United States.

Current California Law (Sec. 25101 and 25110)

With respect to a "water's-edge election" the income subject to California apportionment is generally the income for federal purposes of the corporations within the electing group, including the income under the federal rules for Subpart F income. However, California does not follow the FSC and DISC exemption/deferral of income provisions. All of the income and factors of FSCs and DISCs are required to be included in the water's-edge combined report.

With respect to banks and corporations, other than water's-edge corporations, California uses the world wide combined reporting (WWCR) method of determining the income subject to California tax.

New Federal Law (Sec. 861-865, 921-927, 951-964 and 991-996))

The Revenue Reconciliation Act of 1993 modifies certain provisions of the Internal Revenue Code as they apply to exporters of unprocessed timber which is a softwood. For this purpose, the term "unprocessed timber" means any log, cant, or similar form of timber.

The Revenue Reconciliation Act of 1993 excludes from the definition of "export property" for purposes of the FSC rules any unprocessed timber which is a softwood. Similarly, it excludes from the definition of "export property" for purposes of the DISC rules any unprocessed timber which is a softwood.

The Revenue Reconciliation Act of 1993 also amends the sales source rules as they apply to inventory property. In this case, it provides that any income from the sale of any unprocessed timber which is a softwood and which was cut from an area located in the United States would be domestic source income.

Finally, the Revenue Reconciliation Act of 1993 treats as Subpart F foreign base company sales income any income derived by a controlled foreign corporation in connection with the sale of any unprocessed timber which is a softwood and was cut from an area located in the United States. In addition, it treats as Subpart F foreign base company sales income any income derived by a controlled foreign corporation from the milling of any such timber outside the United States. Any of this type of income which is treated as Subpart F income that is earned by an export trade corporation is not subject to reduction by the export trade income of the corporation.

Effective Date of New Federal Law

Becomes effective for transactions occurring after August 10, 1993.

Impact on California Revenue

Any revenue gain for 1994-5 for certain Water's Edge electors would be rather minor (less than $1 million).

B-IV: Revenue Increases - Transportation Fuels Provisions

Public Law: 103-66

Act Section: 13241-13245

Section Title: Transportation Fuels Provisions

Prior Federal Law (Sec. 4041, 4081, 4091, 6416, 6421, 6427, 9502 and 9503)

Several separate Federal excise taxes are imposed on specified transportation fuels. Taxable fuels include motor fuels (gasoline, diesel fuel and special motor fuels) used for highway transportation gasoline used in motorboats diesel fuel used in trains fuels used in inland waterways transportation and aviation fuel (gasoline and jet fuel) used in most aviation.

Current California Law

The Board of Equalization administers the motor vehicle fuel tax.

New Federal Law (Sec. 4041, 4081, 4091, 6416, 6421, 6427, 9502 and 9503)

The tax base is expanded to include compressed natural gas (CNG) used in highway motor vehicles or motorboats, and jet fuel used in noncommercial aviation. In addition, gasoline and jet fuel used in commercial aviation is subject to the 4.3 cent-per-gallon rate beginning on October 1, 1995 (with appropriate floor stocks taxes being imposed on that date).

CNG used in highway vehicles or motorboats is taxed at a rate of 48.54 cents per mcf (thousand cubic feet) at standard temperature and pressure. The tax is collected on the retail sale or use of CNG under the same provisions as the special motor fuels tax currently is collected.

Revenues from the new 4.3-cents-per-gallon tax (48.54 cents per mcf on compressed natural gas) are retained in the General Fund of the Treasury.

The Revenue Reconciliation Act of 1993 provides that the full 20.1 cents per gallon diesel fuel excise tax rate will be collected on removal from a terminal (i.e., at the terminal rack) under generally the same rules as the gasoline tax currently is collected. However, unlike the gasoline tax, removal of diesel fuel that is destined for an exempt use will not be taxed as the fuel is removed from the terminal if certain dyeing (and marking) requirements are met.

The Revenue Reconciliation Act of 1993 also extends the additional 2.5-cents-per-gallon motor fuels tax rate from October 1, 1995, through September 30, 1999, except that the tax is 1.25 cents per gallon on diesel used in trains. The provision retains present-law motor fuels tax exemptions.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

Effective Date of New Federal Law

The transportation fuels provision is effective on October 1, 1993, with appropriate floor stocks taxes being imposed on that date. The provision applies to diesel fuel removed from terminals after December 31, 1993.

Impact on California Revenue

Requires Board of Equalization review.

B-V: Revenue Increases - Compliance Provisions

Public Law: 103-66

Act Section: 13251

Section Title: Modifications to Substantial Understatement Penalty

Prior Federal Law (Sec. 6662(d), 6664(c), and 6694(a))

A 20-percent penalty is imposed on any portion of an underpayment of tax that is attributable either to a substantial understatement of income tax on a return, or to negligence or disregard of rules or regulations.

A $250 penalty with respect to a return or claim for refund of income tax may be imposed on the preparer if any understatement of tax liability on the return or claim for refund resulted from a position that did not have a realistic possibility of being sustained on its merits and the preparer knew or reasonably should have known of the position. The penalty is $1,000 per return or claim for refund if the understatement is due to any reckless or intentional disregard of rules or regulations.

These penalties may be avoided where the position taken on the return or claim for refund either (1) was based on "substantial authority" or (2) is adequately disclosed on the return or the claim for refund.

Current California Law (Sec. 19164 and 19166)

California is conformed, by reference, to federal rules that relate to penalties imposed on taxpayers and tax preparers with regard to the substantial understatement of tax.

Although California is conformed, state law contains "stand-alone" language that resolves certain discrepancies that would otherwise occur if such "stand-alone" language were not provided. That is, the federal provision refers to "U.S. district court" and makes reference to other federal provisions, while the state's statute refers to "superior court" and makes reference to other state provisions.

New Federal Law (Sec. 6662(d)(2)(B)(ii))

Under the new federal law, the "adequate disclosure" rule is modified by adding to that provision a "reasonable basis" standard. However, no statutory definition of the higher "reasonable basis" standard is provided. The committee reports state that the "reasonable basis" standard is intended to "be a relatively high standard of tax reporting, that is significantly higher than patently improper." Definition of the new standard will be provided by the Secretary of the Treasury in the rule making process. This tougher disclosure standard applies to the taxpayer and not the tax preparer.

Effective Date of New Federal Law

Applies to tax returns due (without regard to extensions) after December 31, 1993.

Impact on California Revenue

Federal estimates are very minor. Any impact on penalty collections under conformity would be insignificant.

B-V: Revenue Increases - Compliance Provisions

Public Law: 103-66

Act Section: 13252

Section Title: Returns Relating to the Cancellation of Indebtedness by Certain Financial Entities

Prior Federal Law (Sec. 6050P)

Under Section 61(a)(12), a taxpayer's gross income includes income from the discharge of indebtedness. The Code, however, does not currently require lenders to file information returns with respect to discharged debt.

The determination of when a discharge of indebtedness occurs under Section 61(a)(12) is a question of fact. See, e.g., Carl T. Miller Trust v. Commissioner, 76 T.C. 191 (1981). In general, a debtor has discharge of indebtedness income where a debt is repurchased or otherwise deemed satisfied for less than its outstanding balance. For example, discharge of indebtedness income may be triggered by a debt modification under Code Section 1001 or where a court adjudicates favorably a defense for the borrower. Discharge of indebtedness income is generally not deemed to result merely because the lender (1) has not actively pursued its claim against the debtor, provided a legal claim still exists, (2) claims a deduction for financial or regulatory reporting purposes, or (3) claims a partial or full bad debt deduction for tax purposes. However, the existence of several factors such as these may, when considered collectively, indicate that a discharge of indebtedness has occurred.

Pursuant to a 1984 Office of Management and Budget memorandum, Treasury Department guidelines currently require Federal agencies to report forgiven debt amounts exceeding $600 to the Internal Revenue Service (IRS) on a Form 1099-G, except where prohibited by law. The Federal Deposit Insurance Corporation (FDIC) and Resolution Trust Corporation (RTC) do not issue such reports because of concerns that information reporting may violate the Right to Financial Privacy Act of 1978 (RFPA). The RFPA permits such information reporting if the Code specifically requires it.

Current California Law (Sec. None)

California conforms with the federal rules and does not require information returns.

New Federal Law (Sec. 6050P)

The Revenue Reconciliation Act of 1993 requires "applicable financial entities" to file information returns with the IRS regarding any discharge of indebtedness (within the meaning of Sec. 61(a)(12)) of $600 or more. Such information returns are required regardless of whether the debtor is subject to tax on the discharged debt. For example, Congress does not expect reporting financial institutions and agencies to determine whether the debtor qualifies for an exclusion under Section 108.

The information return must set forth the name, address and taxpayer identification number of the person whose debt was discharged, the amount of debt discharged, and the date on which the debt was discharged. The information return must be filed in the manner and at the time specified by the IRS. The same information also must be provided to the person whose debt is discharged by January 31 of the year following the discharge.

"Applicable financial entities" include: (1) the FDIC, the RTC, the National Credit Union Administration, and any successor or subunit of any of them; (2) any financial institution (as described in Secs. 581 or 591(a)); (3) any credit union; and (4) any subsidiary of an entity described in (2) or (3) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities. In addition, other Federal agencies (which are required to report under current Treasury Department guideline) are also subject to this provision, so that all federal agencies are subject to uniform rules.

The penalties for failure to file correct information reports with the IRS and to furnish statements to taxpayers are similar to those imposed with respect to a failure to provide other information returns. For example, the penalty for failure to furnish statements to taxpayers is generally $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

Effective Date of New Federal Law

Non-governmental entities are only required to report under the provision with respect to discharges of indebtedness after December 31, 1993. Accordingly, governmental entities are required to report under the provision with respect to discharges of indebtedness after August 10, 1993. This provision does not alter the present law determination of when a discharge of indebtedness occurs under Section 61(a)(12).

Impact on California Revenue

A baseline revenue gain for 1994-5 of $5 million would occur regardless of conformity.

B-VI: Revenue Increases - Treatment Of Intangibles

Public Law: 103-66

Act Section: 13261

Section Title: Amortization of Goodwill and Certain Other Intangibles

Prior Federal Law (Sec. 197 (new), 167(c), 167(f), 167(g), 642(f), 1016(a), 1060(b), 1060(d), 1245(a), and 1253(d))

In determining taxable Income for Federal income tax purposes, a taxpayer is allowed depreciation or amortization deductions for the cost or other basis of intangible property that is used in a trade or business or held for the production of income if the property has a limited useful life that may be determined with reasonable accuracy. Treas. Reg. Sec. 1.167(a)-(3). These Treasury Regulations also state that no depreciation deductions are allowed with respect to goodwill.

The U.S. Supreme Court recently held that a taxpayer able to prove that a particular asset can be valued, and that the asset has a limited useful life which can be ascertained with reasonable accuracy, may depreciate the value over the useful life regardless of how much the asset appears to reflect the expectancy of continued patronage. However, the Supreme Court also characterized the taxpayer's burden of proof as "substantial" and stated that it "often will prove too great to bear." Newark Morning Ledger Co. v. United States, ___ U.S. ___, 61 U.S.L.W. 4313 at 4320, 4319 (April 20, 1993).

Current California Law (Sec. 17201, 17731, 17732, 17736, 18031, 18036, 18151, 24353, 24916, 24916.2, 24917, 24966.2 and 24990)

In general, California is conformed to the federal treatment of intangibles.

New Federal Law (Sec. 197 (new), 167(c), 167(f), 167(g), 642(f), 1016(a), 1060(b), 1060(d), 1245(a), and 1253(d))

In general

The Revenue Reconciliation Act of 1993 allows an amortization deduction with respect to the capitalized costs of certain intangible property (defined as a "Section 197 intangible") that is acquired by a taxpayer and that is held by the taxpayer in connection with the conduct of a trade or business or an activity engaged in for the production of income. The amount of the deduction is determined by amortizing the adjusted basis (for purposes of determining gain) of the intangible ratably over a 15-year period that begins with the month that the intangible is acquired. No other depreciation or amortization deduction is allowed with respect to a Section 197 intangible that is acquired by a taxpayer.

In general, the provision applies to a Section 197 intangible acquired by a taxpayer regardless of whether it is acquired as part of a trade or business. In addition, the provision generally applies to a Section 197 intangible that is treated as acquired under Section 338 of the Code. The provision generally does not apply to a Section 197 intangible that is created by the taxpayer if the intangible is not created in connection with a transaction (or series of related transactions) that involves the acquisition of a trade or business or a substantial portion thereof.

Except in the case of amounts paid or incurred under certain covenants not to compete (or under certain other arrangements have substantially the same effect as covenants not to compete) and certain amounts paid or incurred on account of the transfer of a franchise, trademark, or trade name, the provision generally does not apply to any amount that is otherwise currently deductible (i.e., not capitalized) under present law.

A statement is included in the Conference Report that no inference is intended as to whether a depreciation or amortization deduction is allowed under present law with respect to any intangible property that is either included in, or excluded from, the definition of a Section 197 intangible. In addition, no inference is intended as to whether an asset is to be considered tangible or intangible property for any other purpose of the Internal Revenue Code.

Definition of Section 197 intangible

In general

The term "Section 197 intangible" is defined as any property that is included in any one or more of the following categories: (1) goodwill and going concern value; (2) certain specified types of intangible property that generally relate to workforce, information base, know-how, customers, suppliers, or other similar items; (3) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof; (4) any covenant not to compete (or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not to compete) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (5) any franchise, trademark, or trade name. Certain types of property, however, are specifically excluded from the definition of the term "Section 197 intangible." The term "Section 197 intangible" does not include: (1) any interest in a corporation, partnership, trust, or estate; (2) any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract; (3) any interest in land; (4) certain computer software; (5) certain interests in films, sound recordings, video tapes, books, or other similar property; (6) certain rights to receive tangible property or services; (7) certain interests in patents or copyrights; (8) any interest under an existing lease of tangible property; (9) any interest under an existing indebtedness (except for the deposit base and similar items of a financial institution); (10) a franchise to engage in any professional sport, and any item acquired in connection with such a franchise; and (11) certain transaction costs.

In addition, the Treasury Department is authorized to issue regulations that exclude certain rights of fixed duration or amount from the definition of a Section 197 intangible.

Goodwill and going concern value

For purposes of the provision, goodwill is the value of a trade or business that is attributable to the expectancy of continued customer patronage, whether due to the name of a trade or business, the reputation of a trade or business, or any other factor.

In addition, for purposes of the provision, going concern value is the additional element of value of a trade or business that attaches to property by reason of its existence as an integral part of a going concern. Going concern value includes the value that is attributable to the ability of a trade or business to continue to function and generate income without interruption notwithstanding a change in ownership. Going concern value also includes the value that is attributable to the use or availability of an acquired trade or business (for example, the net earnings that otherwise would not be received during any period were the acquired trade or business not available or operational).

Workforce, information base, know-how, customer-based intangibles supplier-based intangibles and other similar items

Workforce. -- The term "Section 197 intangible" includes workforce in place (which is sometimes referred to as agency force or assembled workforce), the composition of a workforce (for example, the experience, education, or training of a workforce), the terms and conditions of employment whether contractual or otherwise, and any other value placed on employees or any of their attributes. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of a highly-skilled workforce is to be amortized over the 15-year period. As a further example, the cost of acquiring an existing employment contract (or contracts) or a relationship with employees or consultants (including but not limited to any "key employee" contract or relationship) as part of the acquisition of a trade or business is to be amortized over the specified 15-year period.

Information base. -- The term "Section 197 intangible" includes business books and records, operating systems, and any other information base including lists or other information with respect to current or prospective customers (regardless of the method of recording such information). Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the intangible value of technical manuals, training manuals or programs, data files, and accounting or inventory control systems is to be amortized over the specified 15-year period. As a further example, the cost of acquiring customer lists, subscription lists, insurance expirations, patient or client files, or lists of newspaper, magazine, radio or television advertisers is to be amortized over the specified 15-year period.

Know-how. -- The term "Section 197 intangible" includes any patent, copyright, formula, process, design, pattern, know-how, format, or other similar item and is to be amortized over 15 years. For this purpose, the term "Section 197 intangible" is to include package designs, computer software, and any interest in a film, sound recording, video tape, book, or other similar property, except as specifically provided otherwise.

Customer-based intangibles. -- The term "Section 197 intangible" includes any customer-based intangible, which is defined as the composition of market, market share, and any other value resulting from the future provision of goods or services pursuant to relationships with customers (contractual or otherwise) in the ordinary course of business. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of customer base, circulation base, undeveloped market or market growth, insurance in force, mortgage servicing contracts, investment management contracts, or other relationships with customers that involve the future provision of goods or services, is to be amortized over the specified 15-year period. On the other hand, the portion (if any) of the purchase price of an acquired trade or business that is attributable to accounts receivable or other similar rights to income for those goods or services that have been provided to customers prior to the acquisition of a trade or business is not to be taken into account under the provision.

In addition, the provision specifically provides that the term "customer-based intangible" includes the deposit base and any similar asset of a financial institution. Thus, for example, the portion (if any) of the purchase price of an acquired financial institution that is attributable to the checking accounts, savings accounts, escrow accounts and other similar items of the financial institution is to be amortized over the 15-year period specified in the provision.

Supplier-based intangibles. -- The term "Section 197 intangible" includes any supplier-based intangible, which is defined as the value resulting from the future acquisition of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer. Thus, for example, the portion (if any) of the purchase price of an acquired trade or business that is attributable to the existence of a favorable relationship with persons that provide distribution services (for example, favorable shelf or display space at a retail outlet), the existence of a favorable credit rating, or the existence of favorable supply contracts, is to be amortized over the 15-year period specified in the provision.

Other similar items. -- The term "Section 197 intangible" also includes any other intangible property that is similar to workforce, information base, know-how, customer-based intangibles, or supplier-based intangibles and is amortized over 15 years.

Licenses permits, and other rights granted by governmental units

The term "Section 197 intangible" also includes any license, permit, or other right granted by a governmental unit or any agency or instrumentality thereof (even if the right is granted for an indefinite period or the right is reasonably expected to be renewed for an indefinite period). Thus, for example, the capitalized cost of acquiring from any person a liquor license, a taxi-cab medallion (or license), an airport landing or takeoff right (which is sometimes referred to as a slot), a regulated airline route, or a television or radio broadcasting license is to be amortized over the specified 15-year period. The issuance or renewal of a license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof is to be considered an acquisition of such license, permit, or other right.

Covenants not to complete and other similar arrangements

The term "Section 197 intangible" also includes any covenant not to compete (or other arrangement to the extent that the arrangement has substantially the same effect as a covenant not to compete; hereafter "other similar arrangement") entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof). For this purpose, an interest in a trade or business includes not only the assets of a trade or business, but also stock in a corporation that is engaged in a trade or business or an interest in a partnership that is engaged in a trade or business.

Any amount that is paid or incurred under a covenant not to compete (or other similar arrangement) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof) is chargeable to capital account and is to be amortized ratably over the 15-year period specified in the provision. In addition, any amount that is paid or incurred under a covenant not to compete (or other similar arrangement) after the taxable year in which the covenant (or other similar arrangement) was entered into is to be amortized ratably over the remaining months in the 15-year amortization period that applies to the covenant (or other similar arrangement) as of the beginning of the month that the amount is paid or incurred.

For purposes of this provision, an arrangement that requires the former owner of an interest in a trade or business to continue to perform services (or to provide property or the use of property) that benefit the trade or business is considered to have substantially the same effect as a covenant not to compete to the extent that the amount paid to the former owner under the arrangement exceeds the amount that represents reasonable compensation for the services actually rendered (or for the property or use of property actually provided) by the former owner. As under present law, to the extent that the amount paid or incurred under a covenant not to compete (or other similar arrangement) represents additional consideration for the acquisition of stock in a corporation, such amount is not to be taken into account under this provision but, instead, is to be included as part of the acquirer's basis in the stock.

The Conference Report states that the Revenue Reconciliation Act of 1993 contains a technical correction conforming the statute to both the House and Senate committee reports regarding the amortization of covenants not to compete. The correction provides that a covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) shall not be considered to have been disposed of or to have become worthless until the disposition or worthlessness of all interests in the trade or business or substantial portion thereof that was directly or indirectly acquired in connection with such covenant (or other arrangement). Thus, for example, in the case of an indirect acquisition of a trade or business (e.g., through the acquisition of stock that is not treated as an asset acquisition), it is clarified that a covenant not to compete (or other arrangement) entered into in connection with the indirect acquisition cannot be written off faster than on a straight-line basis over 15 years (even if the covenant or other arrangement expires or otherwise becomes worthless) unless all the trades or businesses indirectly acquired (e.g., acquired through such stock interest) are also disposed of or become worthless.

Franchises, trademarks, and trade names

The term "Section 197 intangible" also includes any franchise, trademark, or trade name. For this purpose, the term "franchise" is defined, as under present law, to include any agreement that provides one of the parties to the agreement the right to distribute, sell or provide goods, services, or facilities, within a specified area. In addition, as provided under present law, the renewal of a franchise, trademark, or trade name is to be treated as an acquisition of such franchise, trademark, or trade name.

The provision continues the present-law treatment of certain contingent amounts that are paid or incurred on account of the transfer of a franchise, trademark, or trade name. Under these rules, a deduction is allowed for amounts that are contingent on the productivity, use, or disposition of a franchise, trademark, or trade name 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 payable under a fixed formula. Any other amount, whether fixed or contingent, that is paid or incurred on account of the transfer of a franchise, trademark, or trade name is chargeable to capital account and is to be amortized ratably over the specified 15-year period.

Exceptions to the definition of a Section 197 intangible

In general. -- The provision contains several exceptions to the definition of the term "Section 197 intangible." Several of the exceptions contained in the provision apply only if the intangible property is not acquired in a transaction (or series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business. It is anticipated that the Treasury Department will exercise its regulatory authority to require any intangible property that could otherwise be excluded from the definition of the term "Section 197 intangible" to be taken into account under circumstances where the acquisition of the intangible property is, in and of itself, the acquisition of an asset which constitutes a trade or business or a substantial portion of a trade or business.

The determination of whether acquired assets constitute a substantial portion of a trade or business is to be based on all of the facts and circumstances, including the nature and the amount of the assets acquired as well as the nature and amount of the assets retained by the transferor. It is not intended, however, that the value of the assets acquired relative to the value of the assets retained by the transferor is determinative of whether the acquired assets constitute a substantial portion of a trade or business.

For purposes of the provision, a group of assets is to constitute a trade or business if the use of such assets would constitute a trade or business for purposes of Section 1060 of the Code (i.e., if the assets are of such a character that goodwill or going concern value could under any circumstances attach to the assets). In addition, the acquisition of a franchise, trademark or trade name is to constitute the acquisition of a trade or business or a substantial portion of a trade or business.

In determining whether a taxpayer has acquired an intangible asset in a transaction (or series of related transactions) that involves the acquisition of assets that constitute a trade or business or a substantial portion of a trade or business, only those assets acquired in a transaction (or a series of related transactions) by a taxpayer (and persons related to the taxpayer) from the same person (and any related person) are to be taken into account. In addition, any employee relationships that continue (or covenants not to compete that are entered into) as part of the transfer or assets are to be taken into account in determining whether the transferred assets constitute a trade or business or a substantial portion of a trade or business.

Interests in a corporation, partnership, trust, or estate. -- The term "Section 197 intangible" does not include any interest in a corporation, partnership, trust, or estate. Thus, for example, the provision does not apply to the cost of acquiring stock, partnership interests, or interests in a trust or estate, whether or not such interests are regularly traded on an established market.

Interests under certain financial contracts. -- The term "Section 197 intangible" does not include any interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract, whether or not such interest is regularly traded on an established market. Any interest under a mortgage servicing contract, credit card servicing contract or other contract to service indebtedness issued by another person, and any interest under an assumption reinsurance contract is not excluded from the definition of the term "Section 197 intangible" by reason of the exception for interests under certain financial contracts.

Interests in land. -- The term "Section 197 intangible" does not include any interest in land. Thus, the cost of acquiring an interest in land is to be taken into account under present law rather than under the provision. For this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral rights, timber rights, grazing rights, riparian rights, air rights, zoning variances, and any other similar rights with respect to land. An interest in land is not to include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television services.

The costs of acquiring licenses, permits, and other rights relating to improvements to land, such as building construction or use permits, are to be taken into account in the same manner as the underlying improvement in accordance with present law.

Certain computer software. -- The term "Section 197 intangible" does not include computer software (whether acquired as part of a trade or business or otherwise) that (1) is readily available for purchase by the general public; (2) is subject to a non-exclusive license; and (3) has not been substantially modified. In addition, the term "Section 197 intangible" does not include computer software which is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

For purposes of the provision, the term "computer software" is defined as any program (i.e., any sequence of machine-readable code) that is designed to cause a computer to perform a desired function. The term "computer software" includes any incidental and ancillary rights with respect to computer software that (1) are necessary to effect the legal acquisition of the title to, and the ownership of, the computer software, and (2) are used only in connection with the computer software. The term "computer software" does not include any data base or similar item (other than a data base or item that is in the public domain and that is incidental to the software) regardless of the form in which it is maintained or stored.

If a depreciation deduction is allowed with respect to any computer software that is not a Section 197 intangible, the amount of the deduction is to be determined by amortizing the adjusted basis of the computer software ratably over a 36-month period that begins with the month that the computer software is placed in service. For this purpose, the cost of any computer software that is taken into account as part of the cost of computer hardware or other tangible property under present law is to continue to be taken into account in such manner. In addition, the cost of any computer software that is currently deductible (i.e., not capitalized) under present law is to continue to be taken into account in such manner under the provision.

Certain interests in films, sound recordings, video tapes, books, or other similar property. -- The term "Section 197 intangible" does not include any interest (including an interest as a licensee) in a film, sound recording, video tape, book, or other similar property (including the right to broadcast or transmit a live event) if the interest is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

Certain rights to receive tangible property or services. -- The term "Section 197 intangible" does not include any right to receive tangible property or services under a contract (or any right to receive tangible property or services granted by a governmental unit or an agency or instrumentality thereof) if the right is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

If a depreciation deduction is allowed with respect to a right to receive tangible property or services that is not a Section 197 intangible, the amount of the deduction is to be determined in accordance with regulations to be promulgated by the Treasury Department. It is anticipated that the regulations may provide that in the case of an amortizable right to receive tangible property or services in substantially equal amounts over a fixed period that is not renewable, the cost of acquiring the right will be taken into account ratably over such fixed period. It is also anticipated that the regulations may provide that in the case of a right to receive a fixed amount of tangible property or services over an unspecified period, the cost of acquiring such right will be taken into account under a method that allows a deduction based on the amount of tangible property or services received during a taxable year compared to the total amount of tangible property or services to be received.

For example, assume that a taxpayer acquires from another person a favorable contract right of such person to receive a specified amount of raw materials each month for the next three years (which is the remaining life of the contract) and that the right to receive such raw materials is not acquired as part of the acquisition of assets that constitute a trade or business or a substantial portion thereof (i.e., such contract right is not a Section 197 intangible). It is anticipated that the taxpayer may be required to amortize the cost of acquiring the contract right ratably over the three-year remaining life of the contract. Alternatively, if the favorable contract right is to receive a specified amount of raw materials during an unspecified period, it is anticipated that the taxpayer may be required to amortize the cost of acquiring the contract right by multiplying such cost by a fraction, the numerator of which is the amount of raw materials received under the contract during any taxable year and the denominator of which is the total amount of raw materials to be received under the contract.

It is also anticipated that the regulations may require a taxpayer under appropriate circumstances to amortize the cost of acquiring a renewable right to receive tangible property or services over a period that includes all renewal options exercisable by the taxpayer at less than fair market value.

Certain interests in patents or copyrights. -- The term "Section 197 intangible" does not include any interest in a patent or copyright which is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion of a trade or business.

If a depreciation deduction is allowed with respect to an interest in a patent or copyright and the interest is not a Section 197 intangible, then the amount of the deduction is to be determined in accordance with regulations to be promulgated by the Treasury Department. It is expected that the regulations may provide that if the purchase price of a patent is payable on an annual basis as a fixed percentage of the revenue derived from the use of the patent, then the amount of the depreciation deduction allowed for any taxable year with respect to the patent equals the amount of the royalty paid or incurred during such year.

Interests under leases of tangible property. -- The term Section 197 intangible" does not include any interest as a lessor or lessee under an existing lease of tangible property (whether real or personal). The cost of acquiring an interest as a lessor under a lease of tangible property where the interest as lessor is acquired in connection with the acquisition of the property is to be taken into account as part of the cost of the tangible property. For example, if a taxpayer acquires a shopping center that is leased to tenants operating retail stores, the portion (if any) of the purchase price of the shopping center that is attributable to the favorable attributes of the leases is to be taken into account as a part of the basis of the shopping center and is to be taken into account in determining the depreciation deduction allowed with respect to the shopping center.

The cost of acquiring an interest as a lessee under an existing lease of tangible property is to be taken into account under present law (see Section 178 of the Code and Treas. Reg. Sec. 1.162-11(a)) rather than under the provisions of the Revenue Reconciliation Act of 1993. In the case of any interest as a lessee under a lease of tangible property that is acquired with any other intangible property (either in the same transaction or series of related transactions), however, the portion of the total purchase price that is allocable to the interest as a lessee is not to exceed the excess of (1) the present value of the fair market value rent for the use of the tangible property for the term of the lease, over (2) the present value of the rent reasonably expected to be paid for the use of the tangible property for the term of the lease.

Interests under indebtedness. -- The term "Section 197 intangible" does not include any interest (whether as a creditor or debtor) under any indebtedness that was in existence on the date that the interest was acquired. Thus, for example, the value of assuming an existing indebtedness with a below-market interest rate is to be taken into account under present law rather than under the provision. In addition, the premium paid for acquiring the right to receive an above-market rate of interest under a debt instrument may be taken into account under Section 171 of the Code, which generally allows the amount of the premium to be amortized on a yield-to- maturity basis over the remaining term of the debt instrument. This exception for interests under existing indebtedness does not apply to the deposit base and other similar items of a financial institution.

Professional sports franchises. -- The term "Section 197 intangible" does not include a franchise to engage in professional baseball, basketball, football, or other professional sport, and any item acquired in connection with such a franchise. Consequently, the cost of acquiring a professional sports franchise and related assets (including any goodwill, going concern value, or other Section 197 intangibles) is to be allocated among the assets acquired as provided under present law (see, for example, Section 1056 of the Code) and is to be taken into account under the provisions of present law.

Certain transaction costs. -- The term Section 197 intangible does not include the amount of any fees for professional services, and any transaction costs, incurred by parties to a transaction with respect to which any portion of the gain or loss is not recognized under Part III of Subchapter C. This provision addresses a concern that some taxpayers might attempt to contend that the 15-year amortization provided by the provision applies to any such amounts that may be required to be capitalized under present law but that do not relate to any asset with a readily identifiable useful life. The exception is provided solely to clarify that Section 197 is not to be construed to provide 15-year amortization for any such amounts. No inference is intended that such amounts would (but for this provision) be properly characterized as amounts eligible for such 15-year amortization, nor is any inference intended that any amounts not specified in this provision should be so characterized. In addition, no inference is intended regarding the proper treatment of professional fees or transaction costs in other circumstances under present law.

Regulatory authority regarding rights of fixed term or duration. -- The Revenue Reconciliation Act of 1993 authorizes the Treasury Department to issue regulations that exclude a right received under a contract, or granted by a governmental unit or an agency or instrumentality thereof, from the definition of a Section 197 intangible if (1) the right is not acquired in a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business (or a substantial portion thereof) and (2) the right either (A) has a fixed duration of less than 15 years or (B) is fixed as to amount and the cost is properly recoverable (without regard to this provision) under a method similar to the unit of production method. Generally, it is anticipated that the mere fact that a taxpayer will have the opportunity to renew a contract or other right on the same terms as are available to others, in a competitive auction or similar process that is designed to reflect fair market value and in which the taxpayer is not contractually advantaged, will not be taken into account in determining the duration of such right or whether it is for a fixed amount. However, the fact that competitive bidding occurs at the time of renewal and that there are or may be modifications in price (or in terms or requirements relating to the right that increase the cost to the bidder) shall not be within the scope of the preceding sentence unless the bidding also actually produces a fair market value price comparable to the price that would obtain if the rights were purchased immediately after renewal from a person (other than the person granting the renewal) in an arm's length transaction. Furthermore, it is expected that, as under present law, the Treasury Department will take into account all the facts and circumstances, including any facts indicating an actual practice of renewals or expectancy of renewals.

The regulations may also prescribe rules governing the extent to which renewal options and similar items will be taken into account for the purpose of determining whether rights are fixed in duration or amount. It is also anticipated that such regulations may prescribe the appropriate method of amortizing the capitalized costs of rights which are excluded by such regulations from the definition of a Section 197 intangible.

Exception for certain self-created intangibles

The provision generally does not apply to any Section 197 intangible that is created by the taxpayer if the Section 197 intangible is not created in connection with a transaction (or a series of related transactions) that involves the acquisition of assets which constitute a trade or business or a substantial portion thereof.

For purposes of this exception, a Section 197 intangible that is owned by a taxpayer is to be considered created by the taxpayer if the intangible is produced for the taxpayer by another person under a contract with the taxpayer that is entered into prior to the production of the intangible. For example, a technological process or other know-how that is developed specifically for a taxpayer under an arrangement with another person pursuant to which the taxpayer retains all rights to the process or know-how is to be considered created by the taxpayer.

The exception for "self-created" intangibles does not apply to the entering into (or renewal of) a contract for the use of a Section 197 intangible. Thus, for example, the exception does not apply to the capitalized costs incurred by a licensee in connection with the entering into (or renewal of) a contract for the use of know-how or other Section 197 intangible. These capitalized costs are to be amortized over the 15-year period specified in the provision.

In addition, the exception for "self-created" intangibles does not apply to: (1) any license, permit, or other right that is granted by a governmental unit or an agency or instrumentality thereof; (2) any covenant not to compete (or other similar arrangement) entered into in connection with the direct or indirect acquisition of an interest in a trade or business (or a substantial portion thereof); and (3) any franchise, trademark, or trade name. Thus, for example, the capitalized costs incurred in connection with the development or registration of a trademark or trade name are to be amortized over the 15-year period specified in the provision.

Special rules

Determination of adjusted basis

The adjusted basis of a Section 197 intangible that is acquired from another person generally is to be determined under the principles of present law that apply to tangible property that is acquired from another person. Thus, for example, if a portion of the cost of acquiring an amortizable Section 197 intangible is contingent, the adjusted basis of the Section 197 intangible is to be increased as of the beginning of the month that the contingent amount is paid or incurred. This additional amount is to be amortized ratably over the remaining months in the 15-year amortization period that applies to the intangible as of the beginning of the month that the contingent amount is paid or incurred.

Treatment of certain dispositions of amortizable Section 197 intangibles

Special rules apply if a taxpayer disposes of a Section 197 intangible that was acquired in a transaction or series of related transactions and, after the disposition, the taxpayer retains other Section 197 intangibles that were acquired in such transaction or series or related transactions. First, no loss is to be recognized by reason of such a disposition. Second, the adjusted bases of the retained Section 197 intangibles that were acquired in connection with such transaction or series of related transactions are to be increased by the amount of any loss that is not recognized. The adjusted basis of any such retained Section 197 intangible is increased by the product of (1) the amount of the loss that is not recognized solely by reason of this provision, and (2) a fraction, the numerator of which is the adjusted basis of the intangible as of the date of the disposition and the denominator of which is the total adjusted bases of all such retained Section 197 intangibles as of the date of the disposition.

For purposes of these rules, all persons treated as a single taxpayer under Section 41(f)(1) of the Code are treated as a single taxpayer. Thus, for example, a loss is not to be recognized by a corporation upon the disposition of a Section 197 intangible if after the disposition a member of the same controlled group as the corporation retains other Section 197 intangibles that were acquired in the same transaction (or a series of related transactions) as the Section 197 intangible that was disposed of. It is anticipated that the Treasury Department will provide rules for taking into account the amount of any loss that is not recognized due to this rule (for example, by allowing the corporation that disposed of the Section 197 intangible to amortize the loss over the remaining portion of the 15-year amortization period).

Treatment of certain nonrecognition transactions

If any Section 197 intangible is acquired in a transaction to which Section 332, 351, 361, 721, 731, 1031, or 1033 of the Code applies (or any transaction between members of the same affiliated group during any taxable year for which a consolidated return is filed), the transferee is to be treated as the transferor for purposes of applying this provision with respect to the amount of the adjusted basis of the transferee that does not exceed the adjusted basis of the transferor.

For example, assume that an individual owns an amortizable Section 197 intangible that has been amortized under Section 197 for 4 full years and has a remaining unamortized basis of $300,000. In addition, assume that the individual exchanges the asset and $100,000 for a like-kind amortizable Section 197 intangible in a transaction to which Section 1031 applies. Under the provision, $300,000 of the basis of the acquired amortizable Section 197 intangible is to be amortized over the 10 years remaining in the original 15-year amortization period for the transferred asset and the other $100,000 of basis is to be amortized over the specified 15-year period.

Treatment of certain partnership transactions

Generally, consistent with the rules described above for certain nonrecognition transactions, a transaction in which a taxpayer acquires an interest in an intangible held through a partnership (either before or after the transaction) will be treated as an acquisition to which the provision applies only if, and to the extent that, the acquiring taxpayer obtains, as a result of the transaction, an increased basis for such intangible.

For example, assume that A, B and C each contribute $700 for equal shares in partnership P, which on January 1, 1994, acquires as its sole asset an amortizable Section 197 intangible for $2,100. Assume that on January 1, 1998, (1) the sole asset of P is the intangible acquired in 1994, (2) the intangible has an unamortized basis of $1,500 and A, B, and C each have a basis of $500 in their partnership interests, and (3) D (who is not related to A, B, or C) acquires A's interest in P for $800. Under the provision, if there no Section 754 election in effect for 1998, there will be no change in the basis or amortization of the intangible and D will merely step into the shoes of A with respect to the intangible. D's share of the basis in the intangible will be $500, which will be amortized over the 11 years remaining in the amortization period for the intangible.

On the other hand, if a Section 754 election is in effect for 1998, then D will be treated as having an $800 basis for its share of P's intangible. Under Section 197, D's share of income and loss will be determined as if P owns two intangible assets. D will be treated as having a basis of $500 in one asset, which will continue to be amortized over the 11 remaining years of the original 15-year life. With respect to the other asset, D will be treated as having a basis of $300 (the amount of step-up obtained by D under Section 743 as a result of the Section 754 election) which will be amortized over a 15-year period starting with January of 1998. B and C will each continue to share equally in a $1,000 basis in the intangible and amortize that amount over the remaining 10-year life.

As an additional example, assume the same facts as described above, except that D acquires both A's and B's interests in P for $1,600. Under Section 708, the transaction is treated as if P is liquidated immediately after the transfer, with C and D each receiving their pro rata share of P's assets which they then immediately contribute to a new partnership. The distributions in liquidation are governed by Section 731. Under the provision, C's interest in the intangible will be treated as having a $500 basis, with a remaining amortization period of 11 years. D will be treated as having an interest in two assets: one with a basis of $1,000 and a remaining amortization period of 11 years, and the other with a basis of $600 and a new amortization period of 15 years.

The provision also changes the treatment of payments made in liquidation of the interest of a deceased or retired partner in exchange for goodwill. Except in the case of payments made on the retirement or death of a general partner of a partnership for which capital is not a material income-producing factor, such payments will not be treated as a distribution of partnership income. Under the provision, however, if the partnership makes an election under Section 754, Section 734 will generally provide the partnership the benefit of a stepped-up basis for the retiring or deceased partner's share of partnership goodwill and an amortization deduction for the increase in basis under Section 197.

Treatment of certain reinsurance transactions

The provision applies to any insurance contract that is acquired from another person through an assumption reinsurance transaction (but not through an indemnity reinsurance transaction). The amount taken into account as the adjusted basis of such a Section 197 intangible, however, is to equal the excess of (1) the amount paid or incurred by the acquirer/reinsurer under the assumption reinsurance transaction, over (2) the amount of the specified policy acquisition expenses (as determined under Section 848 of the Code) that is attributable to premiums received under the assumption reinsurance transaction. The amount of the specified policy acquisition expenses of an insurance company that is attributable to premiums received under an assumption reinsurance transaction is to be amortized over the period specified in Section 848 of the Code.

Treatment of amortizable Section 197 intangible as depreciable property

For purposes of Chapter 1 of the Internal Revenue Code, an amortizable Section 197 intangible is to be treated as property of a character which is subject to the allowance for depreciation provided in Section 167. Thus, for example, an amortizable Section 197 intangible is not a capital asset for purposes of Section 1221 of the Code, but an amortizable Section 197 intangible held for more than one year generally qualifies as property used in a trade or business for purposes of Section 1231 of the Code. As further examples, an amortizable Section 197 intangible is to constitute Section 1245 property, and Section 1239 of the Code is to apply to any gain recognized upon the sale or exchange of an amortizable Section 197 intangible, directly or indirectly, between related persons.

Treatment of certain amounts that are properly taken into account in determining the cost of property that is not a Section 197 intangible

The provision does not apply to any amount that is properly taken into account under present law in determining the cost of property that is not a Section 197 intangible. Thus, for example, no portion of the cost of acquiring real property that is held for the production of rental income (for example, an office building, apartment building or shopping center) is to be taken into account under the provision (i.e., no goodwill, going concern value or any other Section 197 intangible is to arise in connection with the acquisition of such real property). Instead, the entire cost of acquiring such real property is to be included in the basis of the real property and is to be recovered under the principles of present law applicable to such property.

Modification of purchase price allocation and reporting rules for certain asset acquisitions

Sections 338(b)(5) and 1060 of the Code authorize the Treasury Department to promulgate regulations that provide for the allocation of purchase price among assets in the case of certain asset acquisitions. Under regulations that have been promulgated pursuant to this authority, the purchase price of an acquired trade or business must be allocated among the assets of the trade or business using the "residual method."

Under the residual method specified in the Treasury regulations, all assets of an acquired trade or business are divided into the following four classes: (1) Class I assets, which generally include cash and cash equivalents; (2) Class II assets, which generally include certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency; (3) Class III assets, which generally include all assets other than those included in Class I, II, or IV (generally all furniture, fixtures, land, buildings, equipment, other tangible property, accounts receivable, covenants not to compete, and other amortizable intangible assets); and (4) Class IV assets, which include intangible assets in the nature of goodwill or going concern value. The purchase price of an acquired trade or business (as first reduced by the amount of the assets included in Class I) is allocated to the assets included in Class II and Class III based on the value of the assets included in each class. To the extent that the purchase price (as reduced by the amount of the assets in Class I) exceeds the value of the assets included in Class II and Class III, the excess is allocable to assets included in Class IV.

It is expected that the present Treasury regulations which provide for the allocation of purchase price in the case of certain asset acquisitions will be amended to reflect the fact that the provision allows an amortization deduction with respect to intangible assets in the nature of goodwill and going concern value. It is anticipated that the residual method specified in the regulations will be modified to treat all amortizable Section 197 intangibles as Class IV assets and that this modification will apply to any acquisition of property to which the provision applies.

Section 1060 also authorizes the Treasury Department to require the transferor and transferee in certain asset acquisitions to furnish information to the Treasury Department concerning the amount of any purchase price that is allocable to goodwill or going concern value. Information furnished to the Treasury Department with respect to certain asset acquisitions is to specify the amount of purchase price that is allocable to amortizable Section 197 intangibles rather than the amount of purchase price that is allocable to goodwill or going concern value. In addition, it is anticipated that the Treasury Department will exercise its existing regulatory authority to require taxpayers to furnish such additional information as may be necessary or appropriate to carry out the provisions of the Act, including the amount of purchase price that is allocable to intangible assets that are not amortizable Section 197 intangibles.

Purchased mortgage servicing rights

The provision excludes purchased mortgage servicing rights (not acquired in connection with the acquisition of a trade or business or substantial portion thereof) from the definition of a Section 197 intangible. Any depreciation deduction allowable with respect to such excluded rights must be computed on a straight line basis over a period of 9 years (108 months).

General regulatory authority

The Treasury Department is authorized to prescribe such regulations as may be appropriate to carry out the purposes of the provision including such regulations as may be appropriate to prevent avoidance of the purposes of the Act through related persons or otherwise. It is anticipated that the Treasury Department will exercise its regulatory authority where appropriate to clarify the types of intangible property that constitute Section 197 intangibles.

The Conference Report contains a statement that the conferees expect that the Treasury Department will provide rules regarding appropriate adjustments, if any, to be made where property acquired after July 25, 1991 has been transferred from one related party group to another in a transaction that would not involve a change in asset basis and one or both groups independently make a July 25, 1991 election that would affect the amortization of such property.

The Conference Report contains a statement that the conferees reiterate the intended purpose of the provision, as stated in both the House and Senate reports, to simplify the law regarding the amortization of intangibles. The severe backlog of cases in audit and litigation is a matter of great concern to the conferees; and any principles established in such cases will no longer have precedential value due to the provision contained in the Revenue Reconciliation Act of 1993. Therefore, the conferees urge the Internal Revenue Service in the strongest possible terms to expedite the settlement of cases under present law. In considering settlements and establishing procedures for handling existing controversies in an expedited and balanced manner, the conferees strongly encourage the Internal Revenue Service to take into account the principles of the provision so as to produce consistent results for similarly situated taxpayers. However, no inference is intended that any deduction should be allowed in these cases for assets that are not amortizable under present law.

The Conference Report contains a statement that the conferees intend that the Treasury Department report annually to the House Ways and Means Committee and the Senate Finance Committee regarding the volume of pending disputes in audit and litigation involving the amortization of intangibles and the progress made in resolving disputes. It is intended that the report also address the effects of the provision on the volume and nature of disputes regarding the amortization of intangibles. It is intended that the first such report shall be made no later than December 31, 1994. The conferees also intend that the Treasury Department conduct a continuing study of the implementation and effects of the Act, including effects on merger and acquisition activities including hostile takeovers and leveraged buyouts. It is expected that the study will address effects of the legislation on the pricing of acquisitions and on the reported values of different types of intangibles (including goodwill). It is intended that the Treasury Department will report the initial results of such study as expeditiously as possible and no later than December 31, 1994. The Treasury Department is expected to provide additional reports annually thereafter.

<u>Effective Date of New Federal Law</u>

The provision generally applies to property acquired after August 10, 1993. However, a taxpayer may elect to apply the provisions to all property acquired after July 25, 1991. In addition, a taxpayer that does not make this election may elect to apply present law (rather than the provisions of the Act) to property that is acquired after August 10, 1993, pursuant to a binding written contract in effect on August 10, 1993, and at all times thereafter until the property is acquired. Finally, special "anti-churning" rules may apply to prevent taxpayers from converting existing goodwill, going concern value, or any other Section 197 intangible for which a depreciation or amortization deduction would not have been allowable under present law into amortizable property to which the provision applies.

Election to apply provision to property acquired after July 25, 1991

A taxpayer may elect to apply the provision to all property acquired by the taxpayer after July 25, 1991. If a taxpayer makes this election, the Act also applies to all property acquired after July 25, 1991, by any taxpayer that is under common control with the electing taxpayer (within the meaning of subparagraphs (A) and (B) of Section 41(f)(1)) of the Code) at any time during the period that began on August 2, 1993, and that ends on the date that the election is made.

Consistent with the operation of the consolidated return rules, for this purpose it is intended that any property acquired after July 25, 1991 by an entity that is a member of an affiliated group filing a consolidated return at the time of such acquisition is treated as property acquired by the taxpayer group filing such return for purposes of any election by that taxpayer group.

An election by an affiliated group filing a consolidated return would not force an election to be made by an acquirer of a former group member, even if such acquirer would normally continue the treatment of such former group member's assets (e.g., an acquirer in a transaction that does not affect the inside basis of the assets of the former group member). Similarly, a failure by the former group to make an election would not affect the ability of the former group member, or a new acquirer that is related to such member on the date of the election, to make an election that would affect the post-July 25, 1991 intangible asset acquisitions of that former group member (including such intangible asset acquisitions made while it was a member of the former group).

The election is to be made at such time and in such manner as may be specified by the Treasury Department, and the election may be revoked only with the consent of the Treasury Department.

Elective binding contract exception

A taxpayer may also elect to apply present law (rather than the provisions of the Revenue Reconciliation Act of 1993) to property that is acquired after August 10. 1993 if the property is acquired pursuant to a binding written contract that was in effect on August 10, 1993 and at all times thereafter until the property is acquired. This election may not be made by any taxpayer that is subject to either of the elections described above that apply the provisions of the Revenue Reconciliation Act of 1993 to property acquired before August 10, 1993.

The election is to be made at such time and in such manner as may be specified by the Treasury Department, and the election may be revoked only with the consent of the Treasury Department.

Impact on California Revenue

Federal estimates indicate moderate net revenue gains overall from this change. This measure is considered a base-line reporting issue under which, as IRS and/or case-law positions are established, taxpayers will report in the same manner for state tax purposes.

B-VI: Revenue Increases - Treatment Of Intangibles

Public Law: 103-66

Act Section: 13262

Section Title: Treatment of Certain Payments To Retired Or Deceased Partner

Prior Federal Law (Sec. 736(b), 736(c), 751(c), and 751(e))

Payments for purchase of goodwill and accounts receivable

A current deduction generally is not allowed for a capital expenditure (i.e., an expenditure that yields benefits beyond the current taxable year). The cost of goodwill acquired in connection with the assets of a going concern normally is a capital expenditure, as is the cost of acquiring accounts receivable. The cost of acquiring goodwill is recovered only when the goodwill is disposed of, while the cost of acquiring accounts receivable is taken into account only when the receivable is disposed of or becomes worthless.

Payments made in liquidation of partnership interest

The tax treatment of a payment made in liquidation of the interest of a retiring or deceased partner depends upon whether the payment is made in exchange for the partner's interest in partnership property. A liquidating payment made in exchange for such property is treated as a distribution by the partnership (Sec. 736(b)). Such distribution generally results in gain to the retiring partner only to the extent that the cash distributed exceeds such partner's adjusted basis in the partnership interest.

A liquidating payment not made in exchange for the partner's interest in partnership property receives either of two possible treatments. If the amount of the payment is determined without reference to partnership income, it is treated as a guaranteed payment and is generally deductible (Sec. 736(a)(2)). If the amount of payment is determined by reference to partnership income, the payment is treated as a distributive share of partnership income, thereby reducing the distributive shares of other partners (which is equivalent to a deduction) (Sec. 736(a)(2)).

A special rule treats amounts paid for goodwill of the partnership (except to the extent provided in the partnership agreement) and unrealized receivables as not made in exchange for an interest in partnership property (Sec. 736(b)(2)(B)). Thus, such amounts may be deductible. Unrealized receivables include unbilled amounts, accounts receivable, depreciation recapture, market discount, and certain other items (Sec. 751(c)).

Sale or exchange of a partnership interest

The sale or exchange of a partnership interest results in capital gain or loss to the transferor partner, except to the extent that ordinary income or loss is recognized with respect to the partner's share of the partnership's unrealized receivables and substantially appreciated inventory items (Sec. 741). It is often unclear whether a payment by a partnership to a retiring partner is made in sale or exchange of, or in liquidation of, a partnership interest.

Current California Law (Sec. 17851, 17855 and 17857)

California conforms to federal law except that:

- o unrealized receivables do not include stock in certain foreign corporations or oil, gas, or geothermal property;
- o the federal rule relating to appreciated inventory items subject to tax as gain on foreign investment company stock does not apply; and
- o the federal rule relating to the limitation of tax on gains from certain sales or exchanges of stock in certain foreign corporations does not apply.

New Federal Law (Sec. 736(b), 736(c), 751(c), and 751(e))

In general

The Revenue Reconciliation Act of 1993 generally repeals the special treatment of liquidation payments made for goodwill and unrealized receivables. Thus, such payments would be treated as made in exchange for the partner's interest in partnership property, and not as a distributive share or guaranteed payment that could give rise to a deduction or its equivalent. The provision does not change present law with respect to payments made to a general partner in a partnership in which capital is not a material income-producing factor. The determination of whether capital is a material income-producing factor would be made under principles of present and prior law. For purposes of this provision, capital is not a material income-producing factor where substantially all the gross income of the business consists of fees, commissions, or other compensation for personal services performed by an individual. The practice of his or her profession by a doctor, dentist, lawyer, architect, or accountant will not, as such, be treated as a trade or business in which capital is a material income- producing factor even though the practitioner may have a substantial capital investment in professional equipment or in the physical plant constituting the office from which such individual conducts his or her practice so long as such capital investment is merely incidental to such professional practice. In addition, the provision does not affect the deductibility of compensation paid to a retiring partner for past services.

Unrealized receivables

The Revenue Reconciliation Act of 1993 also repeals the special treatment of payments made for unrealized receivables (other than unbilled amounts and accounts receivable) for all partners. Such amounts would be treated as made in exchange for the partner's interest in partnership property. Thus, for example, a payment for depreciation recapture would be treated as made in exchange for an interest in partnership property, and not as a distributive share or guaranteed payment that could give rise to a deduction or its equivalent.

Effective Date of New Federal Law

In general, applies to partners retiring or dying on or after January 5, 1993. The provision does not apply to any partner who retires on or after January 5, 1993, if a written contract to purchase the partner's interest in the partnership was binding on January 4, 1993 and at all times thereafter until such purchase. For this purpose, a written contract is to be considered binding only if the contract specifies the amount to be paid for the partnership interest and the timing of any such payments.

Impact on California Revenue

The revenue gain for 1994-5 would be rather minor, on the order of $2 million based on federal projections.

B-VIII: Revenue Increases - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13271

Section Title: Disallowance of Interest on Certain Overpayments of Tax

Prior Federal Law (Sec. 6611(e))

No interest is paid by the Government on a refund arising from an original income tax return if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed (Sec. 6611(e)).

There is no parallel rule for refunds of taxes other than income taxes (i.e., employment, excise, and estate and gift taxes), for refunds of any type of tax arising from amended returns, or for claims for refunds of any type of tax. If a taxpayer files a timely original return with respect to any type of tax and later files an amended return claiming a refund, and if the IRS determines that the taxpayer is due a refund on the basis of the amended return, the IRS will pay the refund with interest computed from the due date of the original return.

Current California Law (Sec. 19349)

No interest is paid by the Franchise Tax Board on a refund arising from an original income tax return if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed. In the case of a return which is filed after the last date prescribed for filing the return (determined with regard to extensions), no interest is allowed or paid for any day before the date on which the return was filed. There is no parallel rule for amended returns.

New Federal Law (Sec. 6611(e))

No interest is to be paid by the Government on a refund arising from any type of original tax return if the refund is issued by the 45th day after the later of the due date for the return (determined without regard to any extensions) or the date the return is filed.

A parallel rule applies to amended returns and claims for refunds: if the refund is issued by the 45th day after the date the amended return or claim for refund is filed, no interest is to be paid by the Government for that period of up to 45 days (interest would continue to be paid for the period from the due date of the return to the date the amended return or claim for refund is filed). If the IRS does not issue the refund by the 45th day after the date the amended return or claim for refund is filed, interest would be paid (as under present law) for the period from the due date of the original return to the date the IRS pays the refund.

A parallel rule also applies to IRS-initiated adjustments (whether due to computational adjustments or audit adjustments). With respect to these adjustments, the IRS is to pay interest for 45 fewer days than it otherwise would.

Effective Date of New Federal Law

The extension of the 45-day processing rule is effective for returns required to be filed (without regard to extensions) on or after January 1, 1994. The amended return rule is effective for amended returns and claims for refunds filed on or after January 1, 1995 (regardless of the taxable period to which they relate). The rule relating to IRS-initiated adjustments applies to refunds paid on or after January 1, 1995 (regardless of the taxable period to which they relate).

Impact on California Revenue

Based on available state data, the reduction in interest payments would be rather minor, less than $1 million annually.

B-VIII: Revenue Increases - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13272

Section Title: Denial of Deduction Relating to Travel Expenses

Prior Federal Law (Sec. 274(m))

In general, a taxpayer is permitted a deduction for all ordinary and necessary expenses paid or incurred during the taxable year (1) in carrying on any trade or business and (2) in the case of an individual, for the production of income. Such deductible expenses may include reasonable travel expenses paid or incurred while away from home, such as transportation costs and the cost of meals and lodging.

In the case of ordinary and necessary business expenses, if a taxpayer travels to a destination and while at that destination engages in both business and personal activities, travel expenses to and from such destination are deductible only if the trip is related primarily to the taxpayer's trade or business. If the trip is primarily personal in nature, expenses while at the destination that are properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible (Treas. Reg. 1.162-2(b)(1)).

Under Treasury regulations, if the taxpayer's spouse accompanies the taxpayer on a business trip, expenses attributable to the spouse's travel are not deductible unless it is adequately shown that the spouse's presence on the trip has a bona fide business purpose (Treas. reg. 1.162-2(c)). The performance of some incidental service by the spouse does not cause the expenses to qualify as deductible business expenses. Under the Treasury regulations, the same rules apply to any other members of the taxpayer's family who accompany the taxpayer on such a trip.

Current California Law (Sec. 17201, 17271 and 24443)

California is conformed, by reference, to federal law relating to deductible travel expenses.

New Federal Law (Sec. 274(m))

The Revenue Reconciliation Act of 1993 denies a deduction for travel expenses paid or incurred with respect to a spouse, dependent, or other individual accompanying a person on business travel, unless (1) the spouse, dependent, or other individual accompanying the person is a bona fide employee of the person paying or reimbursing the expenses, (2) the travel of the spouse, dependent, or other individual is for a bona fide business purpose, and (3) the expenses of the spouse, dependent, or other individual would otherwise be deductible. No inference is intended as to the deductibility of these expenses under present law. The denial of the deduction does not apply to expenses that would otherwise qualify as deductible moving expenses.

Effective Date of New Federal Law

The provision is effective for amounts paid or incurred after December 31, 1993.

Impact on California Revenue

The revenue gain for 1994-5 under the Personal Income Tax law is estimated to be on the order of $1 million based on federal projections.

B-VIII: Revenue Increases - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13273

Section Title: Increase in Withholding From Supplemental Wage Payments

Prior Federal Law (Sec. 3402(g))

Under Treasury regulations, withholding on supplemental wage payments (such as bonuses, commissions, and overtime pay) that are not paid concurrently with wages (or that are paid concurrently with wages, but are separately stated) for a payroll period may be done at a rate of 20 percent (at the employer's election) (Treas. Reg. sec. 31.3402(g)-1).

Current California Law

The California withholding on supplemental wage payments is set by statute at 6 percent and is administered by the Employment Development Department.

New Federal Law (Sec. 3402(g)(noncodified))

The Revenue Reconciliation Act of 1993 increases the applicable withholding rate on supplemental wage payments to 28 percent.

Effective Date of New Federal Law

The provision is effective for payments made after December 31, 1993.

Impact on California Revenue

Not applicable. This federal change is related to the increase in their top tax rates. California's withholding rate was increased in 1992 from 3% to 6%.

C-I: Empowerment Zones, Enterprise Communities, Rural Development Investment Areas, Etc.

Public Law: 103-66

Act Section: 13301-13303

Section Title: Empowerment Zones, Enterprise Communities, And Rural Development Areas

Prior Federal Law (Sec. None)

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes (e.g., low-income housing credit and qualified mortgage bond provisions target certain economically distressed areas). In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or possessions of the United States to encourage the conduct of trades or businesses within these areas.

Current California Law (Sec. 17201, 17250, 17252.5, 17265, 17858, 23802, 24349, 24356.2 and 24356.3)

California has targeted economically distressed areas within the State by creating Enterprise Zones, Program Areas, Local Area Military Base Recovery Areas and the Los Angeles Revitalization Zone. These areas are designated as eligible for tax benefits for 15 years. Tax benefits for businesses operating within the zones include hiring credits, direct expensing provisions, special rules which allow 100 percent carryover of net operating losses, and provisions which allow third party lenders to exclude from income the interest earned from loans to businesses operating within these targeted areas. The incentive credits are allowed to reduce regular tax below the tentative minimum tax.

New Federal Law (Sec. 38, 39, 51, 280C, 381, 1391-1397D)

A total of 9 empowerment zones and 95 enterprise communities will be designated (subject to availability of eligible areas) during 1994 and 1995. Empowerment zones and enterprise communities will be designated from areas nominated by State and local governments. Empowerment zones will be eligible for additional tax incentives beyond those provided in the areas designated as enterprise communities.

The Secretary of Housing and Urban Development (HUD) will designate in eligible urban areas six empowerment zones and 65 enterprise communities. (The six empowerment zones located in urban areas will include at least one zone in an urban area most populous city of which has a population of 500,000 or less.)

The Secretary of Agriculture will designate in eligible rural areas three empowerment zones and 30 enterprise communities. The designations will be made prior to January 1, 1996.

Designations of areas as empowerment zones or enterprise communities generally will remain in effect for 10 years.

Tax incentives for empowerment zones

Employer wage credit

A 20-percent credit against income tax liability is available to all employers for the first $15,000 of qualified wages paid to each employee who (1) is a zone resident (i.e., his or her principal place of abode is within the zone), and (2) performs substantially all employment services within the zone in a trade or business of the employer.

The maximum credit per qualified employee is $3,000 per year. Wages paid to a qualified employee continue to be eligible for the credit if the employee earns more than $15,000, although only the first $15,000 of wages will be eligible for the credit. The wage credit is available with respect to a qualified employee, regardless of the number of other employees who work for the employer or whether the employer meets the definition of an "enterprise zone business."

The credit will be phased out beginning in 2002. The credit rate will be reduced to 15 percent in 2002, 10 percent in 2003, and five percent in 2004. The credit will not be available after December 31, 2004.

Qualified wages include the first $ 15,000 of "wages," defined to include (1) salary and wages as generally defined for FUTA purposes, and (2) certain training and educational expenses paid on behalf of a qualified employee, provided that (a) the expenses are paid to an unrelated third party and are excludable from gross income of the employee under Section 127, or (b) in the case of an employee under age 19, the expenses are incurred by the employer in operating a youth training program in conjunction with local education officials.

The credit is allowed with respect to full-time and part-time employees. However, the employee must be employed by the employer for a minimum period of at least 90 days. Wages are not eligible for the credit if paid to certain relatives of the employer or, if the employer is a corporation or partnership, certain relatives of a person who owns more than 50 percent of the business. In addition, wages are not eligible for the credit if paid to a person who owns more than five percent of the stock (or capital or profits interests) of the employer.

An employer's deduction otherwise allowed for wages paid is reduced by the amount of credit claimed for that taxable year. Wages are not be taken into account for purposes of the empowerment zone employment credit if taken into account in determining the employer's targeted jobs tax credit (TJTC).

The credit is allowable to offset up to 25 percent of alternative minimum tax liability.

Increased Section 179 expensing

For an enterprise zone business, the expensing allowance for certain depreciable business property provided under Section 179 is increased by the lesser of: (1) $20,000 or (2) the cost of Section 179 property that is "qualified zone property" and that is placed in service during the taxable year. As under present law, the types of property eligible for Section 179 expensing under this provision do not include buildings.

As under present law, the Section 179 expensing allowance is phased out for certain taxpayers with investment in qualified property during the taxable year above a specified threshold. However the present-law phase-out range is applied by taking into account only one-half of the cost of qualified zone property that is Section 179 property. In applying the Section 179 phaseout, the cost of Section 179 property that is not qualified zone property is not reduced.

In general, all other provisions of present-law Section 179 apply to the increased expensing for enterprise zone businesses. Thus, all component members of a controlled group are treated as one taxpayer for purposes of the expensing allowance and the application of the phaseout range (Sec. 179(d)(6)). The limitations apply at both the partnership (and S corporation) and partner (and shareholder) levels. The increased expensing allowance is allowed for purposes of the alternative minimum tax (i.e., it is not treated as an adjustment for purposes of the alternative minimum tax). The Section 179 expensing deduction will be recaptured if the property is not used predominantly in a enterprise zone business (under rules similar to present-law Section 179(d)(10)).

Tax-exempt facility bonds available for both empowerment zones and enterprise communities

In general

The Revenue Reconciliation Act of 1993 creates a new category of exempt facility private activity bonds -- qualified enterprise zone facility bonds -- for use in empowerment zones and enterprise communities. These bonds are fully subject to the State private activity bond volume limitations.

Generally, qualified enterprise zone facility bonds are bonds 95 percent or more of the net proceeds of which are used to finance: (1) qualified zone property the principal user of which is a qualified enterprise zone business, and (2) functionally related and subordinate land located in the empowerment zone or enterprise community. These bonds may only be issued while an empowerment zone or enterprise community designation is in effect.

Effective Date of New Federal Law

Empowerment zone and enterprise community designations will be made only during calendar years 1994 and 1995. The tax incentives will be available during the period that the designation remains in effect, which generally will be a period of 10 years.

Impact on California Revenue

Not applicable; California has its own tax incentives targeting economically-depressed areas in the State.

C-I: Empowerment Zones, Enterprise Communities, Rural Development Investment Areas, Etc.

Public Law: 103-66

Act Section: 13311

Section Title: Credit for Contributions to Certain Community Development Corporations

Prior Federal Law (Sec. None)

There are no tax credits available for contributions to community development corporations (CDCs).

Current California Law (Sec. None)

California has no credit for contributions to CDCs.

New Federal Law (Sec. 38)

Under the Revenue Reconciliation Act of 1993, a taxpayer will receive a credit for qualified cash contributions made to certain CDCs. If a taxpayer makes a qualified contribution, the credit may be claimed by the taxpayer for each taxable year during a 10-year period beginning with the taxable year during which the contribution was made. The credit that may be claimed for each year is equal to five percent of the amount of the contribution to the CDC. Thus, during the 10-year credit period, the taxpayer may claim aggregate credit amounts totalling 50 percent of the contribution.

For purposes of this provision, a qualified contribution is defined as any transfer of cash that meets the following requirements: (1) it is made to one of up to 20 CDCs selected by the Secretary of HUD, provided that the contribution is made during the five-year period after the CDC is so selected by the Secretary of HUD; (2) the amount is available for use by the CDC for at least 10 years; (3) the contribution is to be used by the CDC to provide qualified low-income assistance within its operational area; and (4) the CDC designates the contribution as eligible for the credit. The aggregate amount of contributions which may be designated by a selected CDC as eligible for the credit may not exceed $ 2 million.

Prior to July 1, 1994, the Secretary of HUD may select up to 20 CDCs as eligible to participate in the program (subject to the availability of eligible CDCs), at least four of which must operate in rural areas. To be selected, a CDC must have the following characteristics: (1) it must be a tax-exempt charity described in Section 501(c)(3) of the Code; (2) its principal purposes must include promoting employment and business opportunities for individuals who are residents of its operational area; and (3) its operational area must (a) meet the geographic limitations that would apply if the area were designated as an empowerment zone or enterprise community, (b) have an unemployment rate that is not less than the national average, and (c) have a median family income which does not exceed 80 percent of the median family income of residents within the jurisdiction of the local government.

The credit is subject to the general business credit limitations of Section 38 and, therefore, may not be used to reduce tentative minimum tax.

Effective Date of New Federal Law

This provision is effective on August 10, 1993.

Impact on California Revenue

Not applicable; California has its own tax incentives targeting economically-depressed areas in the State.

C-III: Empowerment Zones, Enterprise Communities, Rural Development Investment Areas, Etc. - Investment In Indian Reservations

Public Law: 103-66

Act Section: 13321-13322

Section Title: Investment In Indian Reservations

Prior Federal Law (Sec. 45A and 168(j) (new))

The Internal Revenue Code does not contain general rules that target specific geographic areas for special Federal income tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes (e.g., low-income housing credit and qualified mortgage bond provisions target certain economically distressed areas). In addition, present law provides favorable Federal income tax treatment for certain U.S. corporations that operate in Puerto Rico, the U.S. Virgin Islands, or a possession of the United Stated to encourage the conduct of trades or businesses within these areas.

Current California Law (Sec. 17201, 17250, 17252.5, 17265, 17858, 23802, 24349, 24356.2 and 24356.3)

California has adopted special rules for the expensing of qualified business property in Enterprise Zones (up to $10,000 depending upon the year in which the Zone was designated), Program Areas (up to $100,000 depending upon the year in which the Area was designated), and the Los Angeles Revitalization Zone (unlimited). These special state rules are more generous than federal law in that they do not contain limitations similar to those contained in IRC Section 179 that limit deductions to the amount of income from the trade or business and which reduce or eliminate the deduction when total investments in business assets exceed $200,000 for the taxable year.

California also has special tax credits for employers in Enterprise Zones, Program Areas and the Los Angeles Revitalization Zone who hire residents of the targeted Enterprise Zone, Program Area or Los Angeles Revitalization Zone.

New Federal Law (Sec. 168(j)(new))

The Revenue Reconciliation Act of 1993 provides the following tax incentives for Indian reservations.

Accelerated Depreciation

With respect to certain property used in connection with the conduct of a trade or business within an Indian reservation, depreciation deductions for purposes of Section 168 will be determined using the following recovery periods:

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

"Qualified Indian reservation property" eligible for accelerated depreciation includes property which is (1) used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation (2) not used or located outside the reservation on a regular basis, (3) not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer (within the meaning of Section 465(b)(43)(C)), and (4) described in the recovery-period table above. In addition, property is not "qualified Indian reservation property" if it is placed in service for purposes of conducting gaming activities.

The provision includes a special rule for "qualified infrastructure property" which may be eligible for the accelerated depreciation even if located outside an Indian reservation, provided that the purpose of such property is to connect with qualified infrastructure property located within the reservation (e.g., roads, power lines, water systems, railroad spurs, and communications facilities). For this purpose, "qualified infrastructure property" must be property that is (1) allowed a depreciation deduction under Section 168, (2) benefits the tribal infrastructure, (3) available to the general public, and (4) placed in service in connection with the taxpayer's active conduct of a trade or business within a reservation.

The depreciation deduction allowed for regular tax purposes is also allowed for purposes of the alternative minimum tax.

Indian employment credit

A credit against income tax liability is also allowed to employers for certain wages and health insurance costs paid or incurred by the employer with respect to certain employees. In general, the amount of the credit allowed an employer for any taxable year equals 20-percent of the sum of (1) the wages paid or incurred by the employer for services performed by an employee while the employee is a qualified employee ("qualified wages"); and (2) the amount paid or incurred by the employer for health insurance (other than health insurance provided pursuant to a salary reduction arrangement) to the extent that such amount is attributable to coverage provided to an employee while the employee is a qualified employee ("qualified employee health insurance costs"). The credit is an incremental credit, such that an employer's current-year qualified wages and qualified employee health insurance costs (up to $20,000 per employee) are eligible for the credit only to the extent that the sum of such costs exceeds the sum of comparable costs paid during 1993 to employees whose wages did not exceed $30,000. For purposes of this limitation, all employees of a controlled group of corporations (or partnerships or proprietorships under common control) are treated as employed by a single employer.

In general, an individual is a qualified employee of an employer for any period only if: (1) the individual is an enrolled member of an Indian tribe or the spouse of an enrolled member of an Indian tribe; (2) substantially all of the services performed during such period by the employee for such employer are performed within an Indian reservation; (3) the principal place of abode of the employee while performing such services is on or near the Indian reservation within which the services are performed; and (4) the employee began work for such employer on or after January 1, 1994.

An employee may be treated as a qualified employee for a maximum period of seven years after the day on which the employee first begins work for the employer. In addition, an employee will not be treated as a qualified employee for any taxable year of the employer if the total amount of wages paid or incurred by the employer with respect to such employee during such taxable year (whether or not for services rendered within the Indian reservation) exceeds an amount determined at an annual rate of $30,000 (as adjusted for inflation for years beginning after 1993). Further, an employee will be treated as a qualified employee for a taxable year of the employer only if more than 50 percent of the wages paid or incurred by the employer to such employee during such taxable year are for services performed in a trade or business of the employer.

Qualified employees do not include certain relatives or dependents of the employer (described under present-law Section 51(i)(1)) or, if the employer is a corporation, certain relatives of a person who owns more than 50 percent of the corporation. In addition, any person who owns more than five percent of the stock of the employer (or if the employer is not a corporation, more than five percent of the capital or profits interests in the employer) cannot be a qualified employee. Finally, a qualified employee does not include any individual if the services performed by the individual for the employer involve certain gaming activities or are performed in a building housing such gaming activities.

A tribal member or spouse is a qualified employee only if he or she works on a reservation (and lives on or near that reservation) and is paid wages that do not exceed $30,000 annually.

The Indian employment credit is allowed with respect to full-time and part-time employees. However, if an employee is terminated less than one year after the date of initial employment, the amount of credits previously claimed by the employer with respect to that employee generally is recaptured (unless the employee voluntarily leaves, becomes disabled, or is fired due to misconduct).

An employer's deduction otherwise allowed for wages is reduced by the amount of the credit claimed for the taxable year. The provision also provides that the employment credit is not refundable. Finally, the Indian employment credit is subject to the general business credit limitations of Section 38, and, therefore, the credit may not be used to reduce tentative minimum tax.

Effective Date of New Federal Law

The accelerated depreciation for Indian reservations is available with respect to property placed in service on or after January 1, 1994, and before December 31, 2003.

The wage credit is available for wages paid or incurred on or after January 1, 1994, in a taxable year that begins before December 31, 2003.

Impact on California Revenue

Not applicable; California has its own tax incentives targeting economically-depressed areas.

D-I: Other Provisions - Disclosure Provisions

Public Law: 103-66

Act Section: 13401-13403

Section Title: Disclosure Provisions

Prior Federal Law (Sec. 6103, 7213 and 7431)

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (Sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (Sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (Sec. 7431). No tax information may be furnished by the Internal Revenue Service (IRS) to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (Sec. 6103(p)).

Department of Veterans Affairs

Among the disclosures permitted under the Code is disclosure to the Department of Veterans Affairs ("DVA") of self-employment tax information and certain tax information supplied to the Internal Revenue Service and Social Security Administration by third parties. Disclosure is permitted to assist DVA in determining eligibility for, and establishing correct benefit amounts under, certain of its needs- based pension and other programs (Sec. 6103(1)(7)(D)(viii)). The income tax returns filed by the veterans themselves are not disclosed to DVA.

The DVA is required to comply with the safeguards currently contained in the Code and in Section 1137(c) of the Social Security Act (governing the use of disclosed tax information). These safeguards include independent verification of tax data, notification to the individual concerned, and the opportunity to contest agency findings based on such information.

The DVA disclosure provision is scheduled to expire after September 30, 1997.

Department of Education

The IRS may disclose to the Department of Education the mailing address of taxpayers who have defaulted on certain student loans. The Department of Education may in turn make this information available to its agents and to the holders of such loans (and their agents) for the purpose of locating the taxpayers and collecting the loan.

Current California Law (Sec. 19543-19553)

Unless specifically provided by statute, it is a misdemeanor for the Franchise Tax Board, or any member, deputy, agent, clerk or other officer or employee of the State of California or any local government in this state to disclose any information on returns, reports or documents required under Parts 10, 10.2 or 11 of the Revenue and Taxation Code.

The statute allows disclosure of information in certain tax related judicial proceedings, certain tax enforcement committees of the Legislature, to the Internal Revenue Service, the Multistate Tax Commission, other tax officials and to the Attorney General in certain circumstances.

In addition, certain information is allowed to be disclosed by the Franchise Tax Board to District Attorneys, the California Parent Locator Service, the Director of Social Services and the Director of Health Services (relating to applicants for aid or delinquent child support), the State Controller (in connection with locating owners of unclaimed property), and the California Student Aid Commission (relating to student aid).

New Federal Law (Sec. 6103(l)(7), and (13)(new))

The Revenue Reconciliation Act of 1993 extends the authority to disclose tax information to the DVA for one year, through September 30, 1998.

Access to certain tax return information to implement direct student loan program

The Revenue Reconciliation Act of 1993 gives the Department of Education access to certain tax return information in order to implement a direct student loan program. The only information the Department of Education is permitted to obtain is the name, address, taxpayer identification number, filing status, and adjusted gross income of the former student. Disclosure of this information may be made only to Department of Education employees and may only be used by these employees in establishing the appropriate income-contingent repayment amount for an applicable student loan. Applicable student loans are loans under the new direct student loan program and other student loans that are in default and have been assigned to the Department of Education. The Department of Education and its employees would be subject to the restrictions on unauthorized disclosure in present law.

The authority to disclose tax information to the Department of Education for purposes of implementing the direct student loan program expires on September 30, 1998.

Access to mailing addresses of taxpayers owing overpayments of Pell Grants

The Revenue Reconciliation Act of 1993 permits the Department of Education to obtain the mailing address of any taxpayer who owes an overpayment (i.e., has received more than the proper amount) on a Federal Pell Grant or who has defaulted on certain additional student loans administered by the Department of Education. This authority is permanent.

Disclosure of information to Department of Housing and Urban Development

The Revenue Reconciliation Act of 1993 permits disclosure of certain tax information with respect to applicants for, and participants in, certain Department of Housing and Urban Development (HUD) programs. Such disclosure may be made only to HUD employees and is to be used solely in verifying the taxpayer's eligibility for (or correct amount of benefits under) those HUD programs. The Act extends the current law restrictions on unauthorized disclosure to HUD and its employees. HUD employees may not redisclose tax information to State or local housing agencies, public housing authorities, or any other third party. However, they may inform such parties of the fact that a discrepancy exists between the information provided by the applicant (or participant) and information provided by other sources.

Effective Date of New Federal Law

The provisions are effective on August 10, 1993.

Impact on California Revenue

Not applicable.

D-II: Other Provisions - Public Debt Limit

Public Law: 103-66

Act Section: 13411

Section Title: Public Debt Limit

Prior Federal Law (Sec. 3101 of Title 31)

The statutory limit on the public debt currently is $4.37 trillion. It was set at this level temporarily in P.L. 103-12, enacted into law on April 6, 1993. The current debt limit will expire after September 30, 1993.

Current California Law

California has no comparable provision.

New Federal Law (Sec. 3101 of Title 31)

The Revenue Reconciliation Act of 1993 repeals the temporary limit that expires after September 30, 1993, and instead increases the statutory limit on the public debt to $4.9 trillion. The new debt limit has no expiration date.

Effective Date of New Federal Law

The provision is effective on August 10, 1993.

Impact on California Revenue

Not applicable.

D-III: Other Provisions - Vaccine Provisions

Public Law: 103-66

Act Section: 13421-13422

Section Title: Vaccine Provisions

Prior Federal Law (Sec. 4131, 4980B(f) and 9510)

The Vaccine Injury Compensation Trust Fund (Vaccine Trust Fund") provides a source of revenue to compensate individuals who are injured (or die) as a result of the administration of certain vaccines: diphtheria, pertussis, and tetanus ("DPT"); diphtheria and tetanus ("DT"); measles, mumps, and rubella ("MMR"); and polio. The Vaccine Trust Fund provides the funding source for the National Vaccine Injury Compensation Program ("Program"), which provides a substitute, Federal "no-fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers.

Under the Program, all persons who were immunized with a covered vaccine after the effective date of the Program, October 1, 1988, are prohibited from commencing a civil action in State court for vaccine-related damages unless they first file a petition with the United States Claims Court, where such petitions are assigned to a special master and governed by streamlined procedural rules designed to expedite the proceedings. In these cases, the Federal Government is the respondent party in the proceedings, and the claimant generally must show only that certain medical conditions (or death) followed the administration of a covered vaccine and that the first onset of symptoms occurred within a prescribed time period. Compensation under the Program generally is limited to actual and projected unreimbursed medical, rehabilitative, and custodial expenses, lost earnings, pain and suffering (or, in the event of death, a recovery for the estate) up to $250,000, and reasonable attorney's fees. Only if the final settlement under the Program is rejected may the claimant proceed with a civil tort action in the appropriate State court, where recovery generally will be governed by State tort law principles, subject to certain limitations and specifications imposed by the National Childhood Vaccine Injury Act of 1986.

Present law authorizes up to $6 million per year from the Vaccine Trust Fund for administrative expenses incurred in administering the Vaccine Injury Compensation Program.

The Vaccine Trust Fund is funded by net revenues from a manufacturer's excise tax on DPT, DT, MMR, and polio vaccines (and any other vaccines used to prevent these diseases).

Prior to the expiration of the vaccine excise tax, the excise tax per dose was $4.56 for DPT, $0.06 for DT, $4.44 for MMR, and $0.29 for polio vaccines.

The vaccine excise tax expired after December 31, 1992. Amounts in the Vaccine Trust Fund are available for the payment of compensation under the Program with respect to vaccines administered after September 30, 1988, and before October 1, 1992.

Current California Law

California has no similar provision.

New Federal Law (Sec. 4131, 4980B(f) and 9510)

Permanent extension of excise tax and Program funding

The Revenue Reconciliation Act of 1993 permanently extends the excise taxes imposed on certain vaccines. Authorization for compensation to be paid from the Vaccine Trust Fund under the National Vaccine Injury Compensation Program for certain damages resulting from vaccines administered after September 30, 1988, also is permanently extended.

Maintenance-of-effort requirement for pediatric vaccine health care coverage

The Revenue Reconciliation Act of 1993 makes the failure of health plans that provide coverage for the cost of pediatric vaccines as of May 1, 1993, to continue to provide that level of coverage subject to the excise tax penalty (under Sec. 4980B(f)) applicable to plans that fail to provide COBRA health plan continuation coverage.

Effective Date of New Federal Law

The extension of coverage under the National Vaccine Injury Compensation Program is effective for vaccines administered on or after October 1, 1992. The extension of the vaccine excise taxes is effective on August 10, 1993, with a floor stocks tax imposed on vaccines purchased after December 31 1992, that are being held for sale or use on August 10, 1993.

The maintenance-of-effort requirement for pediatric vaccine health care coverage applies to plan years beginning after August 10, 1993.

Impact on California Revenue

Not applicable.

D-IV: Other Provisions - Disaster Relief Provisions

Public Law: 103-66

Act Section: 13431

Section Title: Modification Of Involuntary Conversion Rules For Certain Disaster Related Conversions

Prior Federal Law (Sec. 1033)

Under present law, no gain is recognized by the taxpayer if property is involuntarily converted into property similar or related in service or use. If property is involuntarily converted into money or property not similar or related in service or use to the converted property, then gain generally is recognized. If during the applicable period, however, the taxpayer replaces the converted property with property similar or related in service or use to the converted property, the taxpayer may elect to recognize gain only to the extent that the amount realized upon such conversion exceeds the cost of the replacement property. The applicable period begins with the date of the disposition of the converted property (or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier) and generally ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized.

Current California Law (Sec. 18031 and 24943)

California fully conformed to the new federal law in AB 1228 (Stats. 1993, Ch. 725) including the retroactive effective date of September 1, 1991.

New Federal Law (Sec. 1033(a))

The Revenue Reconciliation Act of 1993 contains provisions applicable to taxpayers whose principal residence (or any of its contents) is involuntarily converted as a result of a Presidentially declared disaster. In such cases, no gain is recognized by reason of the receipt of insurance proceeds for unscheduled personal property that was part of the contents of such residence. In the case of any other insurance proceeds for such residence or its contents, the proceeds may be treated as a common pool of funds. If such pool of funds is used to purchase any property similar or related in service or use to the converted residence (or its contents), the taxpayer may elect to recognize gain only to the extent that the amount of the pool of funds exceeds the cost of the replacement property.

In addition, the Revenue Reconciliation Act of 1993 extends the ending of the applicable period for the replacement of property involuntarily converted as a result of a Presidentially declared disaster to four years after the close of the first taxable year in which any part of the gain upon conversion is realized.

TITLE XIII: REVENUE RECONCILIATION ACT OF 1993

The Revenue Reconciliation Act of 1993 applies to residences located in areas subject to a disaster that resulted in a subsequent determination by the President that assistance by the Federal Government was warranted under the Disaster Relief and Emergency Assistance Act.

Effective Date of New Federal Law

The provisions are effective for property involuntarily converted as a result of disasters for which a Presidential declaration is made on or after September 1, 1991, and to taxable years ending on or after such date.

Impact on California Revenue

None. Already conformed in 1993 legislation AB 1228(Stats. 1993, Ch. 725).

D-V: Other Provisions - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13441

Section Title: Increase in Presidential Election Campaign Check-off

Prior Federal Law (Sec. 6096)

The Presidential Election Campaign Fund ("Fund") provides for public financing of a portion of qualified Presidential election campaign expenditures and certain qualified convention costs (Sec. 9001 et seq.). The Fund is financed through the voluntary designation by individual taxpayers on tax returns of $1 of tax liability, which is commonly known as the Presidential election campaign checkoff. The Treasury Department accumulates revenues in the Fund over a four-year period and then disburses funds to eligible candidates for President, Vice President, and conventions during the Presidential election year.

Current California Law

California has no counterpart to the fund for Presidential election campaign expenditures.

New Federal Law (Sec. 6096)

The Revenue Reconciliation Act of 1993 increases the amount of the checkoff from $1 to $3.

Effective Date of New Federal Law

Effective for tax returns required to be filed after December 31, 1993.

Impact on California Revenue

Not applicable.

D-V: Other Provisions - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13442

Section Title: Special Rule For Hospital Services

Prior Federal Law (Sec. 162(n))

Under present law, employers can generally deduct the full cost of health coverage provided to participants under a group health plan. Under New York state law, commercial insurers of inpatient hospital services, group health plans, health maintenance organizations, and Blue Cross and Blue Shield corporations are required to reimburse hospitals for inpatient hospital services at various rates set by the state of New York. In February of 1993, a Federal district court invalidated a number of New York statutes imposing inpatient hospital-rate surcharges on the ground that they were preempted by the Employee Retirement Income Security Act of 1974 (ERISA), but ordered insurers of inpatient hospital services to comply with New York's rate-setting statutes pending a final determination of the case.

Current California Law (Sec. 17201 and 24343)

California is in conformity with the general rule that an employer is allowed to deduct amounts paid or incurred in connection with a group health plan.

New Federal Law (Sec. 162(n))

In general, the Revenue Reconciliation Act of 1993 disallows employer deductions for any amounts paid or incurred in connection with a group health plan (including amounts reimbursed through a voluntary employees' beneficiary association (VEBA)) if the plan fails to reimburse hospitals for inpatient services provided in the state of New York at the same rate that licensed commercial insurers are required to reimburse hospitals for inpatient services for individuals not covered by a group health plan. For purposes of this provision, a licensed commercial insurer is a commercial insurer licensed to do business in the state of New York and authorized to write accident and health insurance, and whose policies provide inpatient hospital coverage on an expense incurred basis. Blue Cross and Blue Shield is not a licensed commercial insurer for this purpose.

If a group health plan provides inpatient hospital services through a health maintenance organization (HMO), the Revenue Reconciliation Act of 1993 disallows employer deductions in connection with the plan if the plan fails to reimburse hospitals for inpatient services at the same rate (without regard to exempt individuals) that HMOs are required to reimburse hospitals for individuals not covered by a group health plan.

If a group health plan provides coverage for inpatient hospital services through a Blue Cross and Blue Shield corporation, the Revenue Reconciliation Act of 1993 disallows employer deductions in connection with the plan if the plan fails to reimburse hospitals for inpatient services at the same rate that such corporations are required to reimburse hospitals for individuals not covered by a group health plan.

The deduction disallowance does not apply to any group health plan which is not required under the laws of the state of New York (determined without regard to this provision or other provisions of Federal law) to reimburse for hospital services at the rates described above. Thus, self-insured plans are not subject to the deduction disallowance with respect to the 11 percent surcharge imposed on commercial insurers through March 31, 1993. Similarly, the deduction disallowance does not apply to self-insured plans that do not provide for reimbursement directly to hospitals on an expense incurred basis. The deduction denial also does not apply to payments by self-insured plans exempt from New York's all-payer reimbursement system because of agreements in effect on May 1, 1985.

No inference is intended as to whether any provision of the New York all-payer hospital reimbursement system is preempted by ERISA.

Effective Date of New Federal Law

The provision is effective with respect to inpatient hospital services provided to participants after February 2, 1993, and on or before May 12, 1995.

Impact on California Revenue

Any impact on State income tax revenues would be very minor and would occur automatically as a result of the federal change.

D-V: Other Provisions - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13443

Section Title: Credit for Portion of Employer Social Security Taxes Paid With Respect to Employee Cash Tips

Prior Federal Law (Sec. 45B)

Under present law, all employee tip income is treated as employer-provided wages for purposes of the Federal Unemployment Tax Act (FUTA) and the Federal Insurance Contributions Act (FICA). For purposes of the minimum wage provisions of the Fair Labor Standards Act (FLSA), reported tips are treated as employer-provided wages to the extent they do not exceed one-half of such minimum wage.

Current California Law

Employment taxes are administered by the Employment Development Department.

New Federal Law (Sec. 38 and 45B)

The Revenue Reconciliation Act of 1993 provides a business tax credit for food or beverage establishments in an amount equal to the employer's FICA tax obligation (7.65 percent) attributable to reported tips with respect to the food or beverage establishment in excess of those treated as wages for purposes of satisfying the minimum wage provisions of the FLSA. A food or beverage establishment is any trade or business (or portion thereof) which provides food or beverages for consumption on the premises and with respect to which the tipping of employees serving food or beverages by customers is customary. No credit is allowed with respect to FICA taxes paid on tips that are not received in connection with the provision of food or beverages on the premises of the establishment. It is intended that the rules under Section 6053(c)(4) apply in determining whether the tips are received with respect to a trade or business (or portion thereof) which provides food or beverages and with respect to which the tipping of employees serving food or beverages by customers is customary.

To prevent double dipping, no deduction is allowed for any amount taken into account in determining the credit. The Act prohibits carryback of unused FICA credits to a taxable year ending before August 10, 1993.

Effective Date of New Federal Law

The provision is effective for taxes paid after December 31, 1993.

Impact on California Revenue

Not applicable; the FICA tax is a federal tax obligation.

D-V: Other Provisions - Miscellaneous Provisions

Public Law: 103-66

Act Section: 13444

Section Title: Availability And Use of Death Information

Prior Federal Law (Sec. 6103)

The Secretary of Health and Human Services is authorized to enter into voluntary contracts with the States for the purpose of obtaining death certificate and other related information. In addition, the Secretary is authorized to redisclose this information to other Federal, State, and local agencies for certain specified purposes, subject to such safeguards as the Secretary determines are necessary to prevent any unauthorized redisclosure. However, because these contracts with the States are entirely voluntary, the States are able, at their discretion, to include contract provisions preventing the Secretary from redisclosing this information to other Federal, State, and local agencies.

Current California Law (Sec. 19543-19553)

Unless specifically provided by statute, it is a misdemeanor for the Franchise Tax Board, or any member, deputy, agent, clerk or other officer or employee of the State of California or any local government in this state to disclose any information on returns, reports or documents required under Parts 10, 10.2 or 11 of the Revenue and Taxation Code.

The statute allows disclosure of information in certain tax related judicial proceedings, certain tax enforcement committees of the Legislature, to the Internal Revenue Service, the Multistate Tax Commission, other tax officials and to the Attorney General in certain circumstances.

In addition, certain information is allowed to be disclosed by the Franchise Tax Board to District Attorneys, the California Parent Locator Service, the Director of Social Services and the Director of Health Services (relating to applicants for aid or delinquent child support), the State Controller (in connection with locating owners of unclaimed property), and the California Student Aid Commission (relating to student aid).

New Federal Law (Sec. 6103)

The Revenue Reconciliation Act of 1993 prohibits the disclosure of Federal tax returns or return information to any agency, body or commission of any State in connection with the administration of State tax laws where the State has not entered into a contract to provide death certificate and related information to the Secretary, or where the State is a party to a contract with the Secretary that includes any restrictions on the use of the death information provided to the Secretary by the State, except that such contract may provide that such information is only to be used for purposes of ensuring that Federal benefits or other payments are not erroneously paid to deceased individuals. This rules does not apply to any State that, on July 1, 1993, was not furnishing by contract any death certificate or related information to the Secretary of Health and Human Services.

Effective Date of New Federal Law

The Revenue Reconciliation Act of 1993 is effective one year after August 10, 1993, except that it is effective two years after August 10, 1993 with respect to a State if it is established to the satisfaction of the Secretary of the Treasury that it is legally impossible under existing State law for such a contract to be signed. Congress intends that the authority of the Secretary of the Treasury to grant an extension of the effective date insure that those States that have not yet entered into a contract with the Federal Government allowing for government-wide dissemination of death information have up to two years to resolve, through their State legislatures, any legal impediments to the timely signing of such a contract.

Impact on California Revenue

None if compliance to federal law is satisified.

EXHIBIT A

EXPIRING TAX PROVISIONS

California Expiration*	Calif. Section	Federal Expiration*	Federal Section	Description and Comments
12/31/93	17052.5 23601.5	Permanent	48	Credit: Solar energy devices
12/31/93	17052.14 23612.5	N/A	N/A	Credit: Recycling equipment
12/31/93	17052.20	N/A	N/A	Credit: Parent who stays at home
12/31/93	17053.7 23621	12/31/94	51-52	Credit: Targeted jobs
12/31/93	17273	12/31/93	162	Deduction: Self-employed health insurance
12/31/93	24357.8	N/A	N/A	Deduction: Contribution of technological equipment to schools
--/--/--	19442	N/A	N/A	Administration: Settlement authority expires on 6/30/94 for disputes existing on or before 1/1/94 (without regard to income or taxable year)
12/31/94	17052.17 23617	N/A	N/A	Credit: Start-up costs for employer-provided child care center
12/31/94	17052.18 23617.5	N/A	N/A	Credit: Employer-provided child care plan
12/31/94	17053.5	N/A	N/A	Credit: Renters (no credit for 1993 or 1994, but resumes in 1995)
12/31/94	17139 24326	Permanent	136	Exclusion: Energy conservation subsidies
12/31/94	17151	12/31/94	127	Exclusion: Employer-provided educational assistance
12/31/94	17201	12/31/94	170	Deduction: Contributions of stock for which market quotations are readily available
12/31/94	17256 24356.5	12/31/04	179A	Deduction: Expensing of clean fuel property
12/31/94	18042 24954	Permanent	1042	Exclusion: Sale of stock to an ESOP
12/31/94	24306	Permanent	133	Exclusion: Interest on loans to ESOPs
12/31/94	24611	Permanent	404	Deduction: Dividends paid to an ESOP

EXHIBIT A

EXPIRING TAX PROVISIONS

California Expiration*	Calif. Section	Federal Expiration*	Federal Section	Description and Comments
06/30/95	23609	06/30/95	41	Credit: Increasing research activities NOTE: The state credit is a permanent provision for individuals (Sec. 17052.12)
12/31/95	17041	N/A	N/A	Tax rates: Temporary 10 and 11 percent brackets for regular tax (permanently capped at 9.3 percent)
12/31/95	17052.11 23603	12/31/04	30	Credit: Clean fuel vehicles
12/31/95	17053 23605	N/A	N/A	Credit: Employer sponsored ridesharing
12/31/95	17053.1	N/A	N/A	Credit: Employer sponsored vanpool
12/31/95	17053.5	N/A	N/A	Credit: Renters (phase-out based upon AGI)
12/31/95	17062	N/A	N/A	Tax rates: Temporary 8.5 percent bracket for alternative minimum tax (permanent rate is 7.0 percent)
12/31/95	18706	N/A	N/A	Voluntary Contribution: Election Campaign Fund
12/31/95	18715	N/A	N/A	Voluntary Contribution: Children's Trust Fund
12/31/95	18724	N/A	N/A	Voluntary Contribution: Senior Citizens
12/31/95	18734	N/A	N/A	Voluntary Contribution: Veterans' Memorial
12/31/95	18745	N/A	N/A	Voluntary Contribution: Fish, Wildlife, and Plants
12/31/95	18766	N/A	N/A	Voluntary Contribution: Alzheimer's Disease
12/31/95	19274	N/A	N/A	Administration: Collection of Delinquent Child Support
12/31/96	17053.8 17053.11 17276.2 23622 23623 24416.2	N/A	N/A	Apportionment Formula: Enterprise Zones, Program Areas, and LA Revitalization Zone

EXHIBIT A

EXPIRING TAX PROVISIONS

California Expiration*	Calif. Section	Federal Expiration*	Federal Section	Description and Comments
12/31/96	17276	Permanent	172	Deduction: Net Operating Losses NOTE: The state deduction is a permanent provision for corporations (Sec. 24416)
12/31/96	18796	N/A	N/A	Voluntary Contribution: Breast Cancer
12/31/97	17052.15 23612.6	N/A	N/A	Credit: Sales and Use taxes paid in the LA Revitalization Zone
12/31/97	17053.10 17053.17 23623.5 23625	N/A	N/A	Credits: Hiring in the LA Revitalization Zone
12/31/97	17233 24385	N/A	N/A	Deduction: Interest earned on loans made to businesses in the LA Revitalization Zone
12/31/97	17266 24356.4	N/A	N/A	Deduction: Expensing of business property in the LA Revitalization Zone
12/31/97	17276.2 24416.2	N/A	N/A	Deduction: Net Operating Losses in the LA Revitalization Zone
12/31/97	18518.5 (1)	N/A	N/A	Voluntary Contribution: Firefighters' Memorial Fund
12/31/97	18816	N/A	N/A	Voluntary Contribution: Library Protection Fund
12/31/98	18152.5	Permanent	1202	Exclusion: Capital Gain on Sale of Small Business Stock
12/31/99	18517 (2)	N/A	N/A	Voluntary Contribution: Mexican American Veterans' Memorial Account

* In general, this is the last calendar year to which the provision applies. Fiscal years beginning within this calendar year are, in general, also covered by the provision. In some cases, the expiration applies to transactions occurring after this date.

(1) Will be renumbered to Sec. 18804 by a technical clean-up bill in 1994

(2) Will be renumbered to Sec. 18821 by a technical clean-up bill in 1994