SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Assm. Rev. & Tax Comm. Analyst: Jeff Garnier Bill Number: AB 1208

Related Bills: See Prior Analysis Telephone: 845-5322 Amended Date: 01/03/00

Attorney: Patrick Kusiak Sponsor:

SUBJECT: Conformity Act of 2000

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO _________________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED ____________ STILL APPLIES.

__X__ OTHER - See comments below.

SUMMARY OF BILL

The Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), in general, conform to the Internal Revenue Code (IRC) either by incorporating the IRC by reference as of a "specified date" or by stand alone language which mirrors the federal provision. Those provisions of California law that are conformed to the IRC currently reflect federal law as of January 1, 1998, unless a specific provision provides otherwise. This bill would change the specified date from January 1, 1998, to January 1, 1999, for taxable and income years beginning on or after January 1, 1999. Changing the specified date automatically conforms to all changes from January 1, 1998, through December 31, 1998, to IRC sections that have been previously incorporated by reference. Thus, California law would conform to numerous changes made to federal income tax law by the IRS Restructuring and Reform Act of 1998 (hereinafter "IRS Reform Act of 1998") and certain other federal acts enacted during 1998.

This bill also would make numerous changes to specifically not conform to particular federal provisions or to modify the general conformity to certain items in the IRC. Additionally, numerous technical changes regarding cross references and the deletion of unnecessary standalone language that was used to conform to federal law changes subsequent to January 1, 1998, and prior to January 1, 1999, are being made by this bill.

This bill also contains two of the department's legislative proposals: "Repeal of Capital Loss Limitation and Carryover Provisions for Corporations" and "Taxation of Non and Part-Year Residents and the Alimony Deduction".

Board Position:			Legislative Director	Date
__X__ S	_____ NA	_____ NP		
_____ SA	_____ O	_____ NAR	Johnnie Lou Rosas	01/20/00
_____ N	_____ OUA	_____ PENDING		

SUMMARY OF AMENDMENT

The amendment made the following changes:

- Changed the operative date for “Employer Deductions for Vacation and Severance Pay” (item two). If this bill is enacted before March 15, 2000, this provision would be operative for income and taxable years beginning on or after January 1, 2000. If enacted after March 15, 2000, this provision would be operative for income and taxable years beginning on or after January 1, 2001. By delaying the operative date of this provision by one year in comparison to most of the other provisions of this bill (and the removal of the following items), this bill becomes revenue neutral for the first year.

- Removed a technical correction to clarify the operative date of “Abatement of Interest by Reason of Presidentially Declared Disasters” (item 12.27). This correction was made by SB 94 (Chap. 931, Stats. 1999).

- Removed a provision that would have revised the LLC annual franchise tax due date to the due date of the return (item 16).

- Removed the provision that would have revised the statute of limitations for "disabled taxpayers” (item 17).

- Removed the provision to eliminate the "AMT limitation on personal exemption credits” (item 18). This provision was enacted into law by AB 1637 (Chap. 1637, Stats. 1999).

- Removed double-joining language to SB 94 (Chap. 931, Stats. 1999).

This bill (under the April 19, 1999 amendment) also conforms to the federal change in the IRS Reform Act of 1998 (P.L. 105-206) that waives the early withdrawal penalties for IRS levies on retirement accounts. This provision has not been discussed in any prior analysis.

EFFECTIVE DATE

As a tax levy, this bill would take effect immediately. Unless otherwise stated, the provisions of this bill would be operative for taxable and income years beginning on or after January 1 1999. The author’s staff has indicated that the operative date will be amended to January 1, 2000.

SPECIFIC FINDINGS

Except for items listed above, the analysis in the Summary of Amendment dated August 23, 1999, still applies.

This bill would make changes affecting the following areas:

1. Deductibility of Meals Provided for the Convenience of the Employer.
2. Employer Deductions for Vacation and Severance Pay.
3. Certain Trade Receivables Ineligible for Mark-To-Market Treatment.
4. Exclusion of Minimum Required Distrib. from AGI for Roth IRA Conversions.
5. Farm Production Flexibility Contract Payments

6. Treatment of Certain Deductible Liquidating Distrib. of RICs and REITs.
7. Tax Treatment of Cash Options for Qualified Prizes.
8. Exclusion from Income for Employer-Provided Transportation Benefits.
9. Payments Received Pursuant to the Ricky Ray Hemophilia Relief Fund Act.
10. Waiver of estimated tax penalty.
11. 1998 Federal Technical Changes.
12. Provision removed by June 29, 1999, amendment.
13. Election to Expense the Cost of Certain Depreciable Assets Permitted Under the B&CTL.
14. Repeal of Capital Loss Limitation and Carryover Provisions for Corporations.
15. Provision removed by August 16, 1999, amendment.
16. Revise LLC Annual Franchise Tax Due Date to Date of Return. This provision was removed by the January 3, 2000 amendment.
17. Statute of Limitations for Disabled Taxpayers. This provision was removed by the January 3, 2000 amendment.
18. Elimination of AMT Limitation on Personal Exemption Credits. This provision was removed by the January 3, 2000 amendment
19. AMT Treatment of Charitable Contributions of Appreciated Property.
20. Taxation of Non and Part-Year Residents and the Alimony Deduction.
21. Waiver of Early-Withdrawal Penalties.

Except for the change in the operative date of item 2, the deletion of items 12.27, 16, 17 and 18, and the addition of item 21, the August 23, 1999 analysis still applies.

21. Waiver of Early-Withdrawal Penalties.

Specific Findings

Generally under federal law, the IRS is authorized to levy upon all non-exempt property or rights to property belonging to the taxpayer. Qualified retirement plans and IRAs are not exempt from levy by the IRS. Moreover, distributions from a qualified plan or IRA are includable in the taxpayer's gross income to the extent that the distribution represents pre-tax contributions or earnings on investments regardless of whether the plan or IRA is subject to levy. Prior to the enactment of the IRS Reform Act of 1998, the amount of the distribution included in the gross income of a taxpayer was subject to a 10% early withdrawal penalty unless the distribution was made after the taxpayer reached age 59½ or one of several other specifically enumerated exceptions applied. Prior to the IRS Reform Act of 1998, distributions made on account of an IRS levy were not listed as an exception to the early withdrawal penalty; thus, such distributions were subject to the penalty unless the distribution met one of the other exceptions. In 1987, the United States Tax Court held that the 10% early withdrawal penalty did not apply to distributions made on account of an IRS levy on the qualified plan. Originally the IRS non-acquiesced the tax court decision. The IRS removed its non-acquiescence from the tax court's decision in 1999, after the passage of IRS Reform Act.

The IRS Reform Act of 1998 provided an exception to the 10% early withdrawal penalty for amounts withdrawn from an employer-sponsored retirement plan or IRA that are subject to a levy by the IRS. This provision only applies if the plan is levied. It does not apply when the IRS has not levied upon the taxpayer and the taxpayer withdraws funds to pay taxes in order to avoid a levy, to obtain the release of a levy on other interests, or in any other situation not specifically addressed by the statutory exceptions.

California law is generally the same as federal law prior to the IRS Reform Act of 1998. FTB is authorized to levy upon all non-exempt property or rights to property belonging to the taxpayer, including qualified retirement plans and IRAs. Distributions from a qualified plan or IRA levied by the FTB are includable in the taxpayer's gross income to the extent that the distribution represents pre-tax contributions or earnings on investments and are subject to a 2½% early withdrawal penalty unless one of the specified exceptions applies.

SB 94 (Chap. 931, Stats. 1999) provided an exception to the 2½% early withdrawal penalty on any distribution from a qualified retirement plan made on account of a notice to withhold (an FTB levy) on the qualified retirement plans. SB 94 did not exempt a distribution from a qualified retirement plan on account of an IRS levy from the state 2½% early withdrawal penalty.

This bill would except a distribution on account of an IRS levy on a retirement plan from the 2½% early withdrawal penalty. This conformity to the federal change is accomplished through changing the specified date.

FISCAL IMPACT

Tax Revenue Estimate

	Effective January 1, 2000*							
	Assumed Enactment After June 30, 2000							
	***With exception of (2) Employer Deductions for Vacation & Severance Pay effective January 1, 2001**							
	Assembly Bill 1208 (As Proposed to be amended 01/14/00)		**Personal Income Tax**			**Bank & Corporation Tax**		
			(in millions)			**(in millions)**		
	Description		**2000-1**	**2001-2**	**2002-3**	**2000-1**	**2001-2**	**2002-3**
1	Exclusion of value of meals to employee		-$1	-$1	-$1	-	-	-
2	Employer Deductions for Vacation and Severance Pay	a/	Insignificant	Minor Gain	Minor Gain	Minor Gain	$2	$3
3	Certain Trade Receivables Ineligible for Mark-To-Market Treatment		Minor Gain	Minor Gain	Minor Gain	$12	$18	$18
4	Exclusion-Min. Req. Distributions from AGI for Roth IRA Conversions	b/	-	-	-	-	-	-
5	Farm Production Flexibility Contract Payments		Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
6	Certain Deductible Liquidating Distributions of RICs & REITs	c/				$40	$5	-
7	Tax Treatment of Cash Options for Qualified Prizes		Minor Loss	Minor Loss	Minor Loss	-	-	-
8	Exclusion from Income for Employer-Provided Transportation Benefits		Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
9	Payments Received Pursuant to the Ricky Ray Hemophilia Relief Fund Act		Insignificant	Insignificant	Insignificant	-	-	-
10	Waiver of Estimate Tax Penalty		No Impact	No Impact	No Impact	No Impact	No Impact	No Impact
11	1998 Federal Technical Changes		Insignificant	Insignificant	Insignificant	Insignificant	Insignificant	Insignificant
12	Deleted		-	-	-	-	-	-
13	B & C Section 179 Expensing Allowance		-	-	-	-$36	-$28	-$27
14	Capital Loss Carry-overs	d/	-	-	-	-$5	$1	$3
15	Deleted		-	-	-	-	-	-
16	Deleted							
17	Deleted					-	-	-
18	Deleted					-	-	-
19	AMT Treatment of Charitable Contributions		-$5	-$5	-$5	-	-	-
19	Non-Resident Alimony Deduction		-$5	-$2	-$2	-	-	-
20	Waiver of Early Withdrawal Penalty for IRS levies on IRAs, etc.	e/	Insignificant	Insignificant	Insignificant	No Impact	No Impact	No Impact
	TOTALS		-$11.0	-$8.0	-$8.0	$11.0	-$2.0	-$3.0
	Minor = Loss or gain of less than $500,000							
a/	Baseline revenue gains are projected to be $65 million for 1999-0 and $3 million thereafter.							
b/	Baseline revenue gains are projected to be $84 million for 2004-5, $101 million for 2005-6, and $99 million for 2006-7.							
	Conformity gains are estimated to be $1 million annually beginning with the fiscal year 2004-5.							
c/	Baseline revenue gains are projected to be $15 million annually beginning in 1998-9,							
d/	Assumes Regulation 25106.5 is in place.							
e/	Assumes enactment after 3/15/00. If enacted on or before 3/15/00, PIT estimates would be "Insignificant" for 1999-0 and "Minor" for 2000-1, 2001-2, and 20002-3. Corporate estimates for earlier enactment would be "Insignificant" for 1999-0 and $3 million each year for 2000-1, 2001-2, and 2002-3.							

BOARD POSITION

Support.

On July 6, 1999, the Franchise Tax Board voted 2-0 to support the June 29, 1999, version of this bill.