

1997 Tax Law Changes Enacted in 1998

Explanation of the Provisions Contained in Senate Bill 519, Enacted March 14, 1998, Affecting 1997 California Tax Returns

General Information

SB 519 (Stats. 1998, Ch. 7) was enacted after California's 1997 tax forms and instructions were distributed. Some provisions of SB 519 apply to 1997 California tax returns and are not contained in the 1997 tax forms instructions. This publication provides information and instructions for provisions affecting the filing of 1997 tax returns.

Purpose

Use this publication to determine if any of the provisions of SB 519 apply to your 1997 tax return.

- **If you have not yet filed your 1997 California tax return** and a provision of SB 519 applies to you, follow the directions under the column "What to do." If you are not affected by the provisions of SB 519, follow the original instructions for the 1997 tax forms.
- **If you have already filed your 1997 California tax return** and if any of the provisions of SB 519 affect your income, deductions, credits or other information included in your original return, you will need to file an amended return. To file an amended return: Individuals use Form 540X; Fiduciaries use Form 541; Corporations use Form 100X; Partnerships use Form 565; and Limited Liability Companies use Form 568.

Forms & Publications Referenced

The titles of forms referred to in this publication are:

Form 100, California Corporation Franchise or Income Tax Return
 Form 100-ES, Corporation Estimated Tax
 Form 100S, California S Corporation Franchise or Income Tax Return
 Form 100X, Amended Corporation Franchise or Income Tax Return
 Form 540, California Resident Income Tax Return
 Form 540A, California Resident Income Tax Return
 Form 540NR, California Nonresident or Part-Year Resident Income Tax Return
 Form 540X, Amended Individual Income Tax Return
 Form 541, California Fiduciary Income Tax Return
 FTB Pub. 1001, Supplemental Guidelines to California Adjustments
 FTB 5805, Underpayment of Estimated Tax by Individuals and Fiduciaries
 FTB 5805F, Underpayment of Estimated Tax by Farmers and Fishermen
 FTB 5806, Underpayment of Estimated Tax by Corporations
 Schedule CA (540), California Adjustments – Residents
 Schedule CA (540NR), California Adjustments – Nonresidents
 Schedule P (100), Alternative Minimum Tax and Credit Limitations – Corporations
 Schedule P (540), Alternative Minimum Tax and Credit Limitations – Residents
 Schedule P (540NR), Alternative Minimum Tax and Credit Limitations – Nonresidents or Part-Year Residents
 Schedule P (541), Alternative Minimum Tax and Credit Limitations – Fiduciaries

Where To Get Income Tax Forms

By Internet – If you have Internet access, you may download, view and print 1994, 1995, 1996 and 1997 California income tax forms and publications. Our Internet address is: <http://www.ftb.ca.gov>

By phone – Call 1-800-338-0505. To order personal income tax forms, select personal income tax form request. To order corporate forms, select corporate income tax form request. Please allow two weeks to receive orders placed by phone or by mail.

By mail – Write to: TAX FORMS REQUEST UNIT, FRANCHISE TAX BOARD, PO BOX 307, RANCHO CORDOVA CA 95741-0307.

If you live outside California, please allow three weeks to receive your order.

General Toll-Free Phone Service

Our general toll-free phone service is available from 7 a.m. until 8 p.m. Monday through Friday from January 2 through April 15, 1998. The best times to call are between 7 a.m. and 10 a.m. and between 6 p.m. and 8 p.m. Service is also available on Saturday, April 4 and April 11, from 8 a.m. until 5 p.m. After April 15, service is available Monday through Friday, from 8 a.m. until 5 p.m. From within the United States, call 1-800-852-5711. From outside the United States, call 1-916-845-6500 (not toll free). For hearing impaired with TDD, call 1-800-822-6268.

Subject	Description & Effective Date	What to Do: Individuals & Fiduciaries	What to Do: Business Entities
Rollover of Gain From the Sale of California Small Business Stock	California law now conforms to federal law to the extent that it allows a tax-free rollover of capital gain from the sale of California small business stock. The tax-free rollover is permitted for California purposes if: <ul style="list-style-type: none"> • The sale occurs after 8/5/97; and • The stock sold is from a small business located in California and is held for more than 6 months; and • The proceeds from the sale are used, within 60 days of the sale, to purchase the stock of another small business located in California.¹ 	If you realized a gain from the sale of California small business stock that meets the conditions for the California tax-free rollover (described in this chart), you do not need to make an adjustment for California purposes. Therefore, disregard the instructions contained in the 1997 FTB Pub. 1001 on this topic.	N/A
Survivor Annuity Benefits For a Public Safety Officer Killed in the Line of Duty	California law now conforms to federal law regarding the tax treatment of such benefits. Survivor benefits received in taxable years beginning after 12/31/96, with respect to individuals dying after 12/31/96, are now excluded from gross income. ²	If you exclude such annuity payments on your 1997 federal return, disregard the 1997 Instructions for Schedule CA (540 and 540NR), line 16, regarding the California adjustment for survivor annuity benefits.	N/A
Gain on the Sale of Livestock Sold Due to Flood or Other Weather-Related Conditions	California law now conforms to federal law that allows special treatment for gains on the sale of livestock after 12/31/96 due to floods and other weather-related conditions (in addition to droughts). ³	If you had a gain on the sale of livestock, sold after 12/31/96, due to drought, floods or other weather-related conditions, and made a federal election to defer recognition of gain or treat the sale as an involuntary conversion, you do not need to make an adjustment for California purposes. Therefore, disregard the instructions contained in the 1997 FTB Pub. 1001 on this topic.	If you had a gain on the sale of livestock, sold after 12/31/96, due to drought, floods or other weather-related conditions, and made a federal election to defer recognition of gain or treat the sale as an involuntary conversion, you do not need to make an adjustment for California purposes.
Sale of Principal Residence – California Return Filing Requirements	The return filing requirement has been reinstated for 1997 for taxpayers who have gain from the sale of their principal residence. ⁴ Therefore, only for purposes of determining whether or not you are required to file a California tax return, include the gain on the sale of your principal residence.	If you have a gain from the sale of your principal residence in 1997, the gain must be included in gross income for purposes of determining whether or not you must file a 1997 California tax return. The California return filing requirements are located on page 2 of your 1997 personal income tax booklet under “Do I Have to File?”	N/A
Repeal of Installment Method Alternative Minimum Tax (AMT) Adjustment for Farmers	California law now conforms to the federal provision that allows farmers to use the installment method of accounting for purposes of California AMT for payments received in taxable or income years beginning on or after 1/1/97 for installment sales related to the sale or disposition of farm property made in taxable or income years beginning after 12/31/87. ⁵	If you are a farmer who received payments for the 1997 taxable year for qualified installment sales made in taxable years beginning after 12/31/87, disregard the 1997 Instructions for Schedule P (540), line 13e; Schedule P (540NR), line 13e; or Schedule P (541), line 4j, when computing California AMT. No adjustment is necessary.	If you are a farmer that received payments for an income year beginning on or after 1/1/97 for qualified installment sales made in income years beginning after 12/31/87, disregard the 1997 Instructions for Schedule P (100), line 2f, when computing California AMT. No adjustment is necessary.
Waiver of Estimated Tax Penalty	Any additions to tax that are due to any underpayment of tax or estimated tax for any period before 4/15/98 and that result from any underpayment for the 1997 or 1998 taxable or income year will be waived, to the extent the underpayment was created or increased by any provision of SB 519.	To request a waiver of the underpayment of estimated tax penalty, get form FTB 5805, or form FTB 5805F, and do the following: <ul style="list-style-type: none"> • Complete form FTB 5805 (or form FTB 5805F) to compute the full penalty that would normally be due; and (continued on page 3)	To request a waiver of the underpayment of estimated tax penalty, get form FTB 5806, and do the following: <ul style="list-style-type: none"> • Complete form FTB 5806 to compute the full penalty that would normally be due; and (continued on page 3)

Subject	Description & Effective Date	What to Do: Individuals & Fiduciaries	What to Do: Business Entities
Waiver of Estimated Tax Penalty (continued)	(See page 2)	<p>(continued from page 2)</p> <ul style="list-style-type: none"> • Check "Yes" on form FTB 5805, Part I, Question 1. (Or if using form FTB 5805F, check the box in Part II, line 16); and • Attach a statement to form FTB 5805 (or form FTB 5805F) explaining that you are requesting a waiver of the penalty because of tax law changes made by SB 519 (Stats. 1998, Ch. 7); and • Attach form FTB 5805 (or form FTB 5805F) and the statement explaining why you are requesting a waiver to the front of your Form 540, Form 540A, Form 540NR or Form 541, on top of all other attachments. 	<p>(continued from page 2)</p> <ul style="list-style-type: none"> • Write "Waiver" in red across the top of form FTB 5806; and • Attach a statement to form FTB 5806 that explains that you are requesting a waiver of the penalty because of tax law changes made by SB 519 (Stats. 1998, Ch. 7); and • Attach form FTB 5806 and the statement explaining why you are requesting a waiver to the front of your Form 100 or Form 100S.
Qualified Funeral Trusts (QFTs)	<p>California law now conforms to federal law on the treatment of qualified funeral trusts for tax years ending after 8/5/97.⁶ The trustee of a pre-need funeral trust can elect special tax treatment for the trust whereby the trust is not treated as a grantor trust and the amount of tax paid on the annual earnings of the trust is determined under the income tax rate schedule applicable to trusts.</p>	<p>To make the election for California purposes in 1997, do the following:</p> <ol style="list-style-type: none"> 1. Complete Form 541 as follows: <ul style="list-style-type: none"> • Enter -0- on Form 541, line 3, line 5, line 6, line 7, line 10, line 13, line 18, line 22 and line 26; • Make entries only on Form 541, line 1, line 2, line 4, line 8, line 9, line 11, line 12, line 14, line 15a, line 15b, line 15c, line 16, line 17, line 20, line 21a, line 23, line 24, line 25 and line 27 through line 39. • Sign Form 541 on the bottom of Side 2; and • Write "QFT" in red across the top margin of Form 541, Side 1. 2. Attach federal Form 1041-QFT to the back of your Form 541. <p>Note: If you are filing a composite return (single return for all QFTs of which you are trustee) for California purposes, be sure to attach a copy of your federal composite Form 1041-QFT and all supporting schedules.</p>	<p>N/A</p>

Subject	Description & Effective Date	What to Do: Individuals & Fiduciaries	What to Do: Business Entities
Qualified Subchapter S Subsidiary (QSSS) Tax Subject to Estimated Tax Payments	The QSSS tax provisions have been modified to provide that the QSSS tax is subject to the estimated tax rules and penalties and is due and payable when the S corporation's first estimated tax payment is due. If the QSSS was acquired during the income year, the QSSS tax would be due with the S corporation's next estimated tax payment after the date of the QSSS election.	N/A	If an S corporation acquires a QSSS after the due date of the first estimated tax installment, be sure to include the QSSS tax amount in the payment for the next estimated tax installment. For example, an S corporation, ACME, acquires a QSSS on May 31, 1998. The \$800 QSSS annual tax should be entered on the Form 100-ES voucher in the QSSS Tax Amount box for Installment 2 that is due on June 15, 1998.
Deferral of Income For Family Farm Corporations	California law now conforms to federal law regarding the repeal of the provision that allowed family farm corporations with income over \$25 million during any year to defer tax if the income was a result of changes in accounting methods that are required of these corporations.	N/A	Suspense accounts for calendar year taxpayers that were established prior to the enactment of SB 519 should be recaptured starting in taxable or income years beginning on or after 1/1/98. Suspense accounts for fiscal year taxpayers should be recaptured starting in taxable or income years beginning after 6/8/97 if their income year ends on or after 12/31/97.
Repeal of the 30% Gross Income Test for Regulated Investment Companies (RICs)	California law now conforms to federal law that repealed the 30% gross income test for taxable or income years beginning after 8/5/97. ⁷	N/A	See the Instructions for federal Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies.
Modification of Rules for Real Estate Investment Trusts (REITs)	California law now conforms to the provisions of the federal Taxpayer Relief Act of 1997 (TRA 1997), P.L. 105-34, regarding REITs for taxable or income years beginning after 8/5/97, other than the provisions relating to the retained capital gain tax credit added by Section 1254 of TRA 1997. In addition, California law retains its non-conformity to the various alternative taxes imposed on certain income and activities of REITs, although such amounts remain includible in the California tax base.	N/A	See the Instructions for federal Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts.

¹Prior to the enactment of SB 519, California did not conform to the federal rollover provisions.

²Prior to the enactment of SB 519, survivor benefits received by a spouse, former spouse or child of a public safety officer killed in the line of duty on or after 1/1/97 were generally includible in income for California purposes.

³Prior to the enactment of SB 519, the following election (for sales after 12/31/96) only applied to sales due to drought conditions (not floods and other weather-related conditions) for California purposes: 1.) Defer recognition of gain on the sale of livestock by cash-method farmers forced to sell such livestock due to drought in an area designated for federal assistance; or 2.) Treat the gain as an involuntary conversion and defer the gain by reinvesting the sales proceeds in similar property within a two-year period.

⁴Prior to the enactment of SB 519, the California return filing requirement relating to the inclusion of gain on the sale of a principal residence applied to taxable years beginning on or after 1998. SB 519 reinstates this filing requirement provision for the 1997 taxable year. Therefore, the provision now applies to taxable years beginning on or after 1/1/97.

⁵Prior to the enactment of SB 519, the installment method of accounting for California AMT purposes was not allowed.

⁶Prior to the enactment of SB 519, trusts created to prepay funeral costs were considered grantor trusts. This required trustees to issue Schedule K-1s to the beneficiaries and required the beneficiaries to report the income on their tax returns.

⁷Prior to the enactment of SB 519, a RIC was subject to the 30% gross income test which provided that a RIC could not derive more than 30% of its gross income from the sale of certain investments that were held for less than 3 months.