STATE OF CALIFORNIA
FRANCHISE TAX BOARD
Legislative Services Bureau
PO Box 1468 MS A350
Sacramento, CA 95812-1468
Telephone (916) 845-4326 Fax (916) 845-5472
E-mail: brian.putler@ftb.ca.gov

M E M O R A N D U M

To: Conformity Interested Parties Date: July 25, 2007

From: Brian Putler

Subject: Analysis of Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Attached is the Franchise Tax Board analysis of each of the provisions of the SBWOTA of 2007, as well the revenue estimates for conforming to that Act.

Attachment 1 is an analysis of the SBWOTA containing:

- The summary of the federal changes from the Joint Committee on Taxation Analysis along with the federal effective date.
- A discussion of current California law, if any.
- A discussion of the revenue impact of conforming to each change in federal law.

Attachment 2 is a table summarizing the conformity revenue impact of conforming to the SBWOTA of 2007.

Director, FTB Legislative Services

Attachment

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

I. SMALL BUSINESS TAX RELIEF PROVISIONS

A. General Provisions

1. Extension and modification of work opportunity tax credit (Act section 8211 and IRC section 51)

Summary of Federal Change from Joint Committee on Taxation Analysis[1]

Explanation of Provision

Extension

The SBWOTA extends the work opportunity tax credit for 44 months (for qualified individuals who begin work for an employer after December 31, 2007, and before September 1, 2011).

Qualified veterans targeted group

The provision expands the qualified veterans' targeted group to include an individual who is certified as entitled to compensation for a service-connected disability and: (1) having a hiring date which is not more than one year after having been discharged or released from active duty in the Armed Forces of the United States, or (2) having been unemployed for six months or more (whether or not consecutive) during the one-year period ending on the date of hiring. Being entitled to compensation for a service-connected disability is defined with reference to section 101 of Title 38, U.S.C., which means having a disability rating of 10-percent or higher for service connected injuries.

Qualified first-year wages

The provision expands the definition of qualified first-year wages from $6,000 to $12,000 in the case of individuals who qualify under either of the new expansions of the qualified veteran group, above. The expanded definition of qualified first-year wages does not apply to the veterans qualified with reference to a food stamp program, as defined under present law.

High-risk youth targeted group

The provision expands the definition of high-risk youths to include otherwise qualifying individuals age 18 but not yet age 40 on the hiring date. Also, the provision expands

[1] Joint Committee on Taxation, *Technical Explanation of the "Small Business and Work Opportunity Tax Act of 2007" And Pension Related Provisions Contained in H.R. 2206 as Considered by the House of Representatives on May 24, 2007*, (JCX-29-07), May 24, 2007. This publication is also available on the web at www.house.gov/jct.

the definition of eligible individuals under this category to include otherwise qualifying individuals from rural renewal counties. For these purposes, a rural renewal county is a county outside a metropolitan statistical area (as defined the Office of Management and Budget) which had a net population loss during the five-year periods 1990-1994 and 1995-1999. Finally, the provision changes the name of the category to the “designated community residents” targeted group.

Vocational rehabilitation referral targeted group

The provision expands the definition of vocational rehabilitation referral to include any individual who is certified by a designated local agency as an individual who has a physical or mental disability that constitutes a substantial handicap to employment and who has been referred to the employer while receiving, or after completing, an individual work plan developed and implemented by an employment network pursuant to subsection (g) of section 1148 of the Social Security Act.

Effective Date

The provisions are effective for individuals who begin work for an employer after the date of enactment (May 25, 2007).

<u>Current California Law</u>

California has no comparable credit.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Not applicable.

2. <u>Increase and extension of expensing for small business</u> (Act section 8212 and IRC section 179)

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Explanation of Provision

The SBWOTA increases the $100,000 and $400,000 amounts to $125,000 and $500,000, respectively, for taxable years beginning in 2007 through 2010. These amounts are indexed for inflation in taxable years beginning after 2007 and before 2011. In addition, the provision extends for one year the increased amount that a taxpayer may deduct and the other section 179 rules applicable in taxable years beginning before 2010. Thus, under the provision, these rules continue in effect for taxable years beginning after 2009 and before 2011.

Effective Date

The provision is effective for taxable years beginning after December 31, 2006.

Current California Law (R&TC sections 17205 and 24356)

California specifically does not allow amounts in excess of $25,000 to be expensed; the placed in service limitation for California purposes remains at $200,000; and the California amounts are not indexed.

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

3. Determination of credit for certain taxes paid with respect to employee cash tips (Act section 8213 and IRC section 45B)

Summary of Federal Change from Joint Committee on Taxation Analysis

Explanation of Provision

The SBWOTA provides that the amount of the tip credit is based on the amount of tips in excess of those treated as wages for purposes of the Fair Labor Standards Act (FLSA) as in effect on January 1, 2007. That is, under the provision, the tip credit is determined based on a minimum wage of $5.15 per hour. Therefore, if the amount of the minimum wage increases, the amount of the Federal Insurance Contributions Act (FICA) tip credit will not be reduced.

Effective Date

The provision applies with respect to tips received for services performed after December 31, 2006.

Current California Law

California has no comparable credit.

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

4. Waiver of individual and corporate alternative minimum tax limits on work opportunity credit and credit for taxes paid with respect to employee cash tips
(Act section 8214 and IRC section 38)

Summary of Federal Change from Joint Committee on Taxation Analysis

Explanation of Provision

The SBWOTA treats the tentative minimum tax as being zero for purposes of determining the tax liability limitation with respect to the work opportunity credit and the credit for taxes paid with respect to employee cash tips. Thus, the work opportunity tax credit and the credit for taxes paid with respect to cash tips may offset the alternative minimum tax liability.

Effective Date

The provision applies to credits determined in taxable years beginning after December 31, 2006.

Current California Law

California has no credits comparable to the federal work opportunity tax credit and the credit for taxes paid with respect to cash tips.

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

5. Family business tax simplification (Act section 8215 and IRC section 761)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

Under federal law, a partnership is defined to include a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation or venture is carried on, and which is not a trust or estate or a corporation (IRC section 7701(a)(2)). A partnership is treated as a pass-through entity, and income earned by the partnership, whether distributed or not, is taxed to the partners. The income of a partnership and its partners is determined under subchapter K of the Code. An election not to be subject to the rules of subchapter K is provided for certain partnerships that meet specified criteria (e.g., the partnership is for investment purposes only, is for the joint production, extraction or use of property but not for selling services or property produced or extracted, or is used by securities dealers for short periods to underwrite, sell or distribute securities). Otherwise, the rules of subchapter K apply to a venture that is treated as a partnership for Federal tax purposes.

In the case of an individual with self-employment income, the income subject to self-employment tax (i.e. Social Security and Medicare tax) is the net earnings from self-employment (IRC section 1402(a)). Net earnings from self-employment is the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the self-employment tax rules. If the individual is a partner in a partnership, the net earnings from self-employment generally include his or her distributive share (whether or not distributed) of income or loss from any trade or business carried on by the partnership.

Explanation of Provision

The SBWOTA generally permits a qualified joint venture whose only members are a husband and wife filing a joint return not to be treated as a partnership for Federal tax purposes. A qualified joint venture is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, (2) both spouses materially participate in the trade or business, and (3) both spouses elect to have the provision apply.

Under the provision, a qualified joint venture conducted by a husband and wife who file a joint return is not treated as a partnership for Federal tax purposes. All items of income, gain, loss, deduction and credit are divided between the spouses in accordance with their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor. Thus, it is anticipated that each spouse would account for his or her respective share on the appropriate form, such as Schedule C. The provision is not intended to change the determination under present law of whether an entity is a partnership for Federal tax purposes (without regard to the election provided by the provision).

For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is taken into account just as it is for Federal income tax purposes under the provision (i.e., in accordance with their respective interests in the venture). A corresponding change is made to the definition of net earnings from self-employment under the Social Security Act.

The provision is not intended to prevent allocations or reallocations, to the extent permitted under present law, by courts or by the Social Security Administration of net earnings from self-employment for purposes of determining Social Security benefits of an individual.

Effective Date

The provision is effective for taxable years beginning after December 31, 2006.

<u>Current California Law (R&TC sections 17851, 17865, and 23038)</u>

California conforms by reference to Subchapter K of the Internal Revenue Code in R&TC section 17851 as of the specified date of January 1, 2005, with specified modifications. In general, the classification of an eligible business entity for California purposes is required to be the same as the eligible business entity's classification under the "check-the-box" regulations for federal purposes. However, this federal statutory provision that overrides the "check-the-box" regulations was enacted after the specified date of January 1, 2005. Additionally, California specifically does not conform to Part IV of Subchapter K of the Internal Revenue Code (sections 771 through 777, inclusive), relating to special rules for electing large partnerships. Registered domestic partners are required to file California returns using the same rules applicable to married persons under federal law.

California has no tax comparable to Social Security or Medicare tax.

Revenue Impact of Conforming to the Change in Federal Law

Estimated Revenue Impact of SBWOTA of 2007 Effective TYBA 12/31/06 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
- < $150,000	- < $150,000	- < $150,000

The revenue estimate is based on federal projections with modifications.

B. Gulf Opportunity Zone Tax Incentives

1. Extension of increased expensing for qualified section 179 Gulf Opportunity Zone property (Act section 8221 and IRC section 1400N (e))

Summary of Federal Change from Joint Committee on Taxation Analysis

Explanation of Provision

The SBWOTA extends the increased expensing amount for property substantially all of the use of which is in one or more specified portions of the GO Zone to property placed in service by the taxpayer on or before December 31, 2008. The specified portions of the Go Zone include the Louisiana parishes of Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany, and Washington, and the Mississippi counties of Hancock, Harrison, Jackson, Pearl River, and Stone.

Effective Date

The provision is effective for taxable years beginning after the date of enactment (May 25, 2007).

Current California Law

California does not conform to IRC sections 1400M-1400T, relating to tax benefits for GO Zones.

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

2. Extension and expansion of low-income housing credit rules for buildings in the GO Zones (Act section 8222 and IRC section 1400N(c))

Summary of Federal Change from Joint Committee on Taxation Analysis
Explanation of Provision

Carryover allocation rule

The SBWOTA makes two modifications to the carryover allocation rule for otherwise qualifying buildings located in the GO Zones placed in service before January 1, 2011. First, it repeals the requirement that 10% of the taxpayer's reasonably expected basis in the project (as of the close of the second calendar year following the calendar year of the allocation) must be incurred as of the later of six months after the allocation is made or the end of the calendar year in which the allocation is made (the “10% rule”). Second, it repeals the requirement that such building be placed in service not later than the close of the second calendar year following the calendar year of the allocation (the “second-year placed in service rule”). These changes apply only to allocations made in 2006, 2007, or 2008 whether made out of the regular credit cap or the additional Gulf Opportunity Zone credit cap. Therefore, an otherwise qualifying building is treated as a qualifying for the credit regardless of whether the 10% rule or the second-year placed in service rule are satisfied if such building in one of the GO Zones: (1) receives an allocation in 2006, 2007, or 2008; and (2) is placed in service before January 1, 2011.

Enhanced credit

The SBWOTA extends the placed in service dates for buildings eligible for the enhanced credit available under the Gulf Opportunity Zone Act of 2005 for two additional years (2009 and 2010) for allocations made in 2006, 2007, or 2008. The provision to treat the GO Zones as a high-cost area is generally effective for calendar years beginning after December 31, 2008, and before January 1, 2011, and for buildings placed-in-service during such period in the case of projects that also receive financing with the proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued during that period. Therefore, otherwise qualifying buildings located in the GO Zones generally are eligible for the enhanced credit for allocations made in 2006, 2007, or 2008, if placed in service after December 31, 2005, and before January 1, 2011.

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Definition of Federally subsidized

The provision modifies the definition of below market Federal loan for otherwise qualifying buildings located in the GO Zones that are placed in service during the period beginning on January 1, 2006, and ending on December 31, 2010. Under the provision, a loan is not treated as a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 by reason of: (1) section 122 of that Act; (2) any provision of the Department of Defense Appropriations Act, 2006 (Pub. L. No. 109-141); or (3) the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006 (Pub. L. No. 109-234). Therefore, such assistance will not cause an otherwise qualifying building receiving such assistance to be treated as Federally subsidized for purposes of the low income housing credit.

Rehabilitation expenditures

The Congress expects that the present law rules treating rehabilitation expenses as a separate new building for purposes of the low-income housing credit will apply in the case of buildings in the GO Zones which have been destroyed and, therefore, must be rehabilitated. For example, if a building receiving the low-income housing credit (with an eligible basis of $100 for credit purposes) was destroyed and the cost of replacing the building is $150, then the Congress expects that present law rules may allow the expenditures that exceed $100 but do not exceed $150 to be treated as a separate building with separate credit and compliance periods, assuming the rehabilitation expenditure receives a credit allocation and meets the otherwise applicable low income housing tax credit requirements.

Effective Date

The provisions are effective upon enactment (May 25, 2007).

<u>Current California Law</u>

California does not conform to IRC sections 1400M-1400T, relating to tax benefits for GO Zones.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Not applicable.

3. <u>Special tax-exempt bond financing rule for repairs and reconstructions of residences in the GO Zones</u> (Act section 8223 and IRC sections 143 and 1400N(a))

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Explanation of Provision

Under the SBWOTA, a qualified GO Zone repair or reconstruction loan is treated as a qualified rehabilitation loan for purposes of the qualified mortgage bond rules. Thus, such loans financed with the proceeds of qualified mortgage bonds and Gulf Opportunity Zone Bonds may be used to acquire or replace existing mortgages, without regard to the existing walls or 20 year rule under present law. The provision defines a qualified GO Zone repair or reconstruction loan as any loan used to repair damage caused by Hurricane Katrina, Hurricane Rita, or Hurricane Wilma to a building located in the GO Zones (or reconstruction of such building in the case of damage constituting destruction) if the expenditures for such repair or reconstruction are 25% or more of the mortgagor's adjusted basis in the residence. For purposes of the provision, the mortgagor's adjusted basis is determined as of the later of (1) the completion of the repair or reconstruction or (2) the date on which the mortgagor acquires the residence.

Effective Date

The provision applies to owner-financing provided after the date of enactment (May 25, 2007), and before January 1, 2011.

Current California Law (R&TC section 17143)

California specifically does not conform to IRC section 143, relating to tax-exempt bonds, in R&TC section 17143. Additionally, California does not conform to IRC sections 1400M-1400T, relating to tax benefits for GO Zones.

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

4. GAO study of practices employed by State and local governments in allocating and utilizing tax incentives provided pursuant to the Gulf Opportunity Zone Tax Act of 2005 (Act section 8224 of the bill)

Summary of Federal Change from Joint Committee on Taxation Analysis

Explanation of Provision

This uncodified provision in the SBWOTA requires the Government Accountability Office (GAO) to conduct a study of the practices employed by State and local governments, and subdivisions thereof, in allocating and utilizing tax incentives provided pursuant to the Gulf Opportunity Act of 2005 (Public Law 109-135) and this Act.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Not more than one year after the date of enactment of this Act, the GAO must submit a report to the House Committee on Ways and Means and the Senate Committee on Finance on the findings of its study and recommendations, if any, relating to such findings. If the GAO report includes findings of significant fraud, waste or abuse, then each of the two committees should hold public hearings to review such findings within 60 days of the submission of the report.

Effective Date

The provision is effective on the date of enactment (May 25, 2007).

Current California Law

California has no comparable provision.

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

C. Subchapter S Provisions (Act sections 8231-8236 and IRC sections 641, 1361 and 1362)

1. Capital gain not treated as passive investment income (Act section 8231)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

An S corporation is subject to corporate-level tax, at the highest corporate tax rate, on its excess net passive income if the corporation has (1) accumulated earnings and profits at the close of the taxable year and (2) gross receipts more than 25% of which are passive investment income.

Excess net passive income is the net passive income for a taxable year multiplied by a fraction, the numerator of which is the amount of passive investment income in excess of 25% of gross receipts and the denominator of which is the passive investment income for the year. Net passive income is defined as passive investment income reduced by the allowable deductions that are directly connected with the production of that income. Passive investment income generally means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (to the extent of gains). Passive investment income generally does not include interest on accounts receivable, gross receipts that are derived directly from the active and regular conduct of a lending or finance business, gross receipts from certain liquidations, gain or loss from any IRC section 1256 contract (or related property) of an options or commodities dealer, or certain interest and dividend income of banks and depository institution of holding companies.

In addition, an S corporation election is terminated whenever the S corporation has accumulated earnings and profits at the close of each of three consecutive taxable years and has gross receipts for each of those years more than 25% of which are passive investment income.

Explanation of Provision

The SBWOTA eliminates gains from sales or exchanges of stock or securities as an item of passive investment income.

Effective Date

The provision applies to taxable years beginning after the date of enactment (May 25, 2007).

Current California Law (R&TC sections 17087.5 and 23800-23808)

California conforms by reference to Subchapter S of the Internal Revenue Code in R&TC section 23800 as of the "specified date" of January 1, 2005, including IRC section 1362(d)(3)(A), relating to termination, and IRC section 1362(d)(3)(B) and (C), relating to the definition of "gross receipts" and "passive investment income." However, R&TC section 23801(a) specifically provides that a federal "S corporation" is an "S corporation" under California law. This particular federal change is applicable for California purposes because the impact of eliminating gains from sales or exchanges of stock or securities as an item of passive investment income will reduce the number of terminations of "S corporation" status under federal law. Those corporations will remain federal "S corporations" and therefore remain "S corporations" under California law.

Additionally, California imposes a tax on passive investment income determined in accordance with federal law, with modifications. California law in R&TC section 23811(a) specifically provides that the California tax on passive investment income may not be imposed on an "S corporation" that has no excess net passive income for federal income tax purposes. Therefore, this particular federal change is applicable for California purposes.

Revenue Impact of Conforming to the Change in Federal Law

Any revenue impact is baseline as these particular federal changes are applicable for California purposes. Based on the federal estimate, the baseline loss for California is deemed to be negligible.

2. Treatment of bank director shares (Act section 8232)

Summary of Federal Change from Joint Committee on Taxation Analysis

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Background

An S corporation may have no more than 100 shareholders and may have only one outstanding class of stock.

An S corporation has one class of stock if all outstanding shares of stock confer identical rights to distribution and liquidation proceeds. Differences in voting rights are disregarded.

National banking law requires that a director of a national bank own stock in the bank and that a bank have at least five directors. A number of States have similar requirements for State-chartered banks. In some cases, a bank director enters into an agreement under which the bank (or a holding company) will reacquire the stock upon the director's ceasing to hold the office of director, at the price paid by the director for the stock.

Explanation of Provision

Under the SBWOTA, restricted bank director stock is not taken into account as outstanding stock in applying the provisions of subchapter S. Thus, the stock is not treated as a second class of stock; a director is not treated as a shareholder of the S corporation by reason of the stock; the stock is disregarded in allocating items of income, loss, etc. among the shareholders; and the stock is not treated as outstanding for purposes of determining whether an S corporation holds 100 percent of the stock of a qualified subchapter S subsidiary.

Restricted bank director stock is stock in a bank (as defined in IRC section 581), or a depository institution holding company (within the meaning of sec. 3(w)(1) of the Federal Deposit Insurance Act), if the stock is required to be held by an individual under applicable Federal or State law in order to permit the individual to serve as a director of the bank or holding company and which is subject to an agreement with the bank or holding company (or corporation in control of the bank or company) pursuant to which the holder is required to sell the stock back upon ceasing to be a director at the same price the individual acquired the stock. A distribution (other than a payment in exchange for the stock) with respect to the restricted stock is includible in the gross income of the director and is deductible by the S corporation for the taxable year that includes the last day of the director's taxable year in which the distribution is included in income.

Effective Date

The provision applies to taxable years beginning after December 31, 2006. The provision also provides that restricted bank director stock is not treated as a second class of stock for taxable years beginning after December 31, 1996.

Current California Law (R&TC sections 17087.5 and 23800-23808)

California conforms by reference to Subchapter S of the Internal Revenue Code in R&TC section 23800 as of the “specified date” of January 1, 2005, with modifications. However, R&TC section 23801(a) specifically provides that a federal “S corporation“ is an “S corporation” under California law. Because the impact of restricted bank director stock not being taken into account as outstanding stock in applying the provisions of subchapter S is a qualification issue, this particular federal change is applicable for California purposes.

Revenue Impact of Conforming to the Change in Federal Law

Any revenue impact is baseline as this particular federal change is applicable for California purposes. Based on the federal estimate, the baseline loss for California is deemed to be insignificant.

3. Treatment of banks changing from reserve method of accounting (Act section 8233)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

A financial institution which uses the reserve method of accounting for bad debts may not elect to be an S corporation. If a financial institution changes from the reserve method of accounting, there is taken into account for the taxable year of the change adjustments to taxable income necessary to prevent amounts from being duplicated or omitted by reason of the change.

Positive adjustments (i.e., additions to taxable income) are generally spread over four taxable years beginning in the year of change. Negative adjustments (i.e., reductions to taxable income) are generally taken into account entirely in the year of change.

In the case of a financial institution that changes from the reserve method and elects to be an S corporation for the year of change, the adjustments are both included in the income of the shareholders and are taken into account in computing the tax on built-in gain under IRC section 1374.

If the change in accounting method is made for the last taxable year prior to becoming an S corporation, any adjustments for that year are taken into account in computing the corporation's taxable income, but not taken into account by the shareholders.

Explanation of Provision

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

The SBWOTA allows a bank which changes from the reserve method of accounting for bad debts for its first taxable year for which it is an S corporation to elect to take into account all adjustments under IRC section 481 by reason of the change in the last taxable year it was a C corporation.

Effective Date

The provision applies to taxable years beginning after December 31, 2006.

<u>Current California Law (R&TC sections 17087.5, 17551, 23800-23808, and 24721)</u>

California conforms by reference to Subchapter S of the Internal Revenue Code in R&TC section 23800 as of the “specified date” of January 1, 2005, including IRC section 1361(b)(2)(A), relating to ineligible corporation defined, and IRC section 481, relating to adjustments required by changes in method of accounting. Because this federal change was made after the “specified date” of January 1, 2005, and is not a “qualification issue,” California is not conformed.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Estimated Revenue Impact of SBWOTA of 2007 Effective TYBA 12/31/06 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
+$1,000,000	- < $250,000	-$1,000,000

The revenue estimate is based on federal projections with modifications.

4. <u>Treatment of sale of an interest in a qualified subchapter S subsidiary</u> (Act section 8234)

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

An S corporation that owns all the stock of a corporation may elect to treat the subsidiary corporation as a qualified subchapter S subsidiary (QSub). A QSub is disregarded as a separate entity for Federal tax purposes and its items of income, deduction, loss, and credit are treated as items of the S corporation.

If the subsidiary corporation ceases to be a QSub (e.g., fails to meet the wholly-owned requirement) the subsidiary is treated as a new corporation acquiring all its assets (and assuming all of its liabilities) immediately before such cessation from the parent S corporation in exchange for its stock. Under Treasury regulations, the tax treatment of the termination of the QSub election is determined under general principals of tax law, including the step transaction doctrine. The regulations set forth an example in which an S corporation sells 21% of the stock of a QSub to an unrelated party. In the example, the deemed transfer of all the assets to the QSub is treated as a taxable sale because the S corporation was not in control of the QSub immediately after the transfer by reason of the sale, and thus the transfer did not qualify for nonrecognition treatment under IRC section 351.

Explanation of Provision

The SBWOTA provides that where the sale of stock of a QSub results in the termination of the QSub election, the sale is treated as a sale of an undivided interest in the assets of the QSub (based on the percentage of the stock sold) followed by a deemed transfer to the QSub in a transaction to which IRC section 351 applies.

Thus, in the above example, the S corporation will be treated as selling a 21% interest in all the assets of the QSub to the unrelated party, followed by a transfer of all the assets to a new corporation in a transaction to which IRC section 351 applies. Thus, the S corporation will recognize 21% of the gain or loss in the assets of the QSub.

The provision is not intended to change the present-law treatment of the disposition of stock of a QSUB by an S corporation in connection with an otherwise non-taxable transaction. For example, the transfer of stock of a QSUB by an S corporation pro rata to its shareholders can qualify as a distribution to which IRC sections 368(a)(1)(D) and 355 apply if the transaction otherwise satisfies the requirements of those sections.

Effective Date

The provision applies to taxable years beginning after December 31, 2006.

<u>Current California Law (R&TC sections 17087.5 and 23800-23808)</u>

California conforms by reference to Subchapter S of the Internal Revenue Code in R&TC section 23800 as of the “specified date” of January 1, 2005, including IRC section 1361(b)(3), relating to treatment of certain wholly owned subsidiaries, with modifications. Because this federal change was made after the “specified date” of January 1, 2005, and is not a “qualification issue,” California is not conformed.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Revenue Impact of Conforming to the Change in Federal Law

Estimated Revenue Impact of SBWOTA of 2007 Effective TYBA 12/31/06 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
- < $150,000	- < $150,000	- < $150,000

The revenue estimate is based on federal projections with modifications.

5. Elimination of earnings and profits attributable to pre-1983 years (Act section 8235)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

The Small Business Jobs Protection Act of 1996 provided that if a corporation was an S corporation for its first taxable year beginning after December 31, 1996, the accumulated earnings and profits of the corporation as of the beginning of that year were reduced by the accumulated earnings and profits (if any) accumulated in a taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S.

Explanation of Provision

The SBWOTA provides in the case of any corporation which was not an S corporation for its first taxable year beginning after December 31, 1996, the accumulated earnings and profits of the corporation as of the beginning of the first taxable year beginning after the date of the enactment of this provision is reduced by the accumulated earnings and profits (if any) accumulated in a taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S.

Effective Date

The provision applies to taxable years beginning after the date of enactment (May 25, 2007).

Current California Law

California conformed to Subchapter S of the Internal Revenue Code in R&TC section 23800 starting in 1987. Therefore this federal provision does not apply to California.

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Revenue Impact of Conforming to the Change in Federal Law

Not applicable.

6. Deductibility of interest expense of an ESBT on indebtedness incurred to acquire S corporation stock (Act section 8236)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

Under IRC section 641, an electing small business trust (ESBT) is subject to a tax at the highest individual income tax rate (currently 35%) on the portion of the trust which consists of stock in one or more S corporations (S portion). The income from the S portion of an ESBT is not included in the beneficiaries' income.

The only items of income, loss, or deduction taken into account in computing the taxable income of the S portion of an ESBT are: (1) the items of income, loss or deduction allocated to it as an S corporation shareholder under the rules of subchapter S, (2) gain or loss from the sale of the S corporation stock, and (3) to the extent provided in regulations, any state or local income taxes and administrative expenses of the ESBT properly allocable to the S corporation stock.

Under Treasury regulations, interest paid by an ESBT to purchase stock in an S corporation is allocated to the S portion of the ESBT but is not a deductible administrative expense for purposes determining the taxable income of the S portion. In determining the tax liability with regard to the remaining portion of the trust, the items taken into account by the subchapter S portion of the trust are disregarded.

Explanation of Provision

The SBWOTA provides that a deduction for interest paid or accrued on indebtedness to acquire stock in an S corporation may be taken into account in computing the taxable income of the S portion of an ESBT.

Effective Date

The provision is effective for taxable years beginning after December 31, 2006.

Current California Law (R&TC sections 17731 and 17731.5)

California conforms by reference to Subchapter J of the Internal Revenue Code (IRC sections 641-692) in R&TC section 17731 as of the “specified date” of January 1, 2005, with modifications to the tax rate and the personal exemption in R&TC section 17731.5.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Because this federal change was made after the "specified date" of January 1, 2005, and is not a "qualification issue," California is not conformed.

Revenue Impact of Conforming to the Change in Federal Law

Estimated Revenue Impact of SBWOTA of 2007 Effective TYBA 12/31/06 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
- < $150,000	- < $150,000	- < $150,000

The revenue estimate is based on federal projections with modifications.

II. REVENUE PROVISIONS

A. Increase in Age of Children Whose Unearned Income is Taxed as if Parents' income (Act section 8241 and IRC section 1(g))

Background

The Tax Increase Prevention and Reconciliation Act (TIPRA) (Public Law 109-222) was enacted on May 17, 2006. Section 510 of TIPRA increased the age of minor children whose unearned income is taxed as if it were the parent's income from a child under 14 years of age to under 18 years of age for 2006 and later taxable years.

Summary of Federal Change from Joint Committee on Taxation Analysis

Explanation of Provision

The SBWOTA expands the kiddie tax to apply to children who are 18 years old or who are full-time students over age 18 but under age 24. The expanded provision applies only to children whose earned income does not exceed one-half of the amount of their support.

Effective Date

The provision is effective for taxable years beginning after the date of enactment (i.e., starting with the 2008 taxable year for most individuals).

Current California Law (R&TC section 17041(g))

California conforms to IRC section 1(g), relating to the kiddie tax, as of the "specified date" of January 1, 2005, before the date of the TIPRA change. Until legislation is enacted to conform to the federal changes, the age to which the California kiddie tax provisions apply remains at under 14 years of age. AB 1561 (Calderon) (2007/08) is proposing to conform to the TIPRA change that increases the age to which the kiddie tax provisions apply from under 14 to under 18 years of age.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Estimated Revenue Impact of SBWOTA of 2007 Effective TYBA 12/31/07 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
+$1,000,000	+$4,000,000	+$6,000,000

According to federal estimates, conforming to the expanded Kiddie Tax on children ages 18 years old or are full-time students over age 18 but under age 24 would result in state revenue gains of roughly $1 million beginning with the 2007-08 fiscal year and around $6 million per year on average thereafter.

<u>B. Suspension of Penalties and Interest</u> (Act section 8242 and IRC section 6404(g))

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

In general, interest and penalties accrue during periods for which taxes were unpaid without regard to whether the taxpayer was aware that there was tax due. IRC section 6404 suspends the accrual of certain penalties and interest starting 18 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. If the return is filed before the due date, for this purpose it is considered to have been filed on the due date. Interest and penalties resume 21 days after the IRS sends the required notice to the taxpayer. The provision is applied separately with respect to each item or adjustment. The provision does not apply where a taxpayer has self-assessed the tax. The suspension applies only to taxpayers who are individuals and who file a timely tax return. In addition, the provision does not apply to the failure-to-pay penalty, in the case of fraud, or with respect to criminal penalties. Generally, the provision also does not apply to interest accruing with respect to underpayments resulting from listed transactions or undisclosed reportable transactions.

Explanation of Provision

The SBWOTA extends the period before which accrual of interest and certain penalties are suspended. Under the provision, the accrual of certain penalties and interest is suspended starting 36 months after the filing of the tax return if the IRS has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability.

Effective Date

The provision is effective for IRS notices issued after the date that is six months after May 25, 2007.

Current California Law (R&TC section 19116)

California is not conformed by reference to IRC Section 6404, relating to interest suspension, but instead has stand-alone provisions in R&TC section 19116 that parallel the federal language. R&TC section 19116 suspends the accrual of certain penalties and interest starting 18 months after the filing of the tax return if the Franchise Tax Board (FTB) has not sent the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability within the specified period. If the return is filed before the due date, for this purpose it is considered to have been filed on the due date. Interest and penalties resume 15 days after the FTB sends the required notice to the taxpayer. In 2005, California conformed its stand-alone provision to the AJCA Act Section 903 amendments to IRC Section 6404(g) to make inapplicable the suspension of interest provisions in the case of gross misstatements, reportable transactions, and listed transactions. However, California has not conformed its stand-alone law to the changes made by section 303 of the Gulf Opportunity Zone Act of 2005, including restarting the “interest suspension period” upon the filing of an amended return. AB 1561 (Calderon) (2007/08) is proposing to conform to section 303 of the Gulf Opportunity Zone Act of 2005, including restarting the “interest suspension period” upon the filing of an amended return.

Revenue Impact of Conforming to the Change in Federal Law

Estimated Revenue Impact of SBWOTA of 2007 Effective for Notices Issued after 1/1/08 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
-	+$7,000,000	+$7,000,000

Based on internal audit program reports, around $10 million in statutory interest is earned on income tax revenue assessments each year. To the extent any future assessments are qualified for the prolonged interest period, an estimated $7 million of additional statutory interest would result annually. This analysis assumes a normal two-year audit cycle and an average audit timeframe of more than twelve months.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

C. Modification of Collection Due Process Procedures for Employment Tax Liabilities (Act section 8243 and IRC section 6330)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

In general, the IRS is required to notify taxpayers that they have a right to a fair and impartial collection due process (CDP) hearing before levy may be made on any property or right to property. Similar rules apply with respect to notices of tax liens, although the right to a hearing arises only on the filing of a notice. The CDP hearing is held by an impartial officer from the IRS Office of Appeals, who is required to issue a determination with respect to the issues raised by the taxpayer at the hearing. The taxpayer is entitled to appeal that determination to a court. Under present law, taxpayers are not entitled to a pre-levy CDP hearing if a levy is issued to collect a Federal tax liability from a State tax refund or if collection of the Federal tax is in jeopardy. However, levies related to State tax refunds or jeopardy determinations are subject to post-levy review through the CDP hearing process.

Employment taxes generally consist of the taxes under the Federal Insurance Contributions Act (FICA), the tax under the Federal Unemployment Tax Act (FUTA), and the requirement that employers withhold income taxes from wages paid to employees (income tax withholding). Income tax withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the employee.

Explanation of Provision

Under the SBWOTA, a levy issued to collect Federal employment taxes is excepted from the pre-levy CDP hearing requirement if the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy is served. However, the taxpayer is provided an opportunity for a hearing within a reasonable period of time after the levy. As the IRC provides for State tax refunds or jeopardy determinations, collection by levy of employment tax liabilities is permitted to continue during the CDP proceedings.

Effective Date

The provision is effective for levies issued on or after the date that is 120 days after May 25, 2007.

Current California Law

The Employment Development Department (EDD), rather than the Franchise Tax Board, administers employment taxes. Defer to EDD.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Defer to EDD.

<u>D. Permanent Extension of IRS User Fees</u> (Act section 8244 and IRC section 7528)

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. These user fees are authorized by statute (IRC section 7528) through September 30, 2014.

Explanation of Provision

The provision permanently extends the statutory authorization for IRS user fees.

Effective Date

The provision is effective for requests made after the date of enactment (May 25, 2007).

<u>Current California Law (None)</u>

California does not conform to IRC section 7528, relating to IRS user fees.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Not applicable.

<u>E. Increase in Penalty for Bad Checks and Money Orders</u> (Act section 8245 and IRC section 6657)

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

IRC section 6657 imposes a penalty on a person who tenders a bad check or money orders. The penalty is two percent of the amount of the bad check or money order. For checks or money orders that are less than $750, the minimum penalty is $15 (or, if less, the amount of the check or money order).

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Explanation of Provision

The SBWOTA increases the minimum penalty to $25 (or, if less, the amount of the check or money order), applicable to checks or money orders that are less than $1,250.

Effective Date

The provision is effective with respect to checks or money orders received after the date of enactment (May 25, 2007).

<u>Current California Law (R&TC section 19134)</u>

California conforms by reference to IRC section 6657 as of the "specified date" of January 1, 2005, in R&TC section 19134, with a modification providing that the penalty also applies to payments made by credit card remittance or electronic funds transfer.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Estimated Revenue Impact of SBWOTA of 2007 Effective for Dishonored Payments received after 6/30/07 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
+ <$500,000	+ <$500,000	+ <$500,000

A $10 increase in the minimum penalty imposed for dishonored payments made in amounts up to $1,250 would likely result in a minor revenue gain of less than $500,000 per year. This analysis assumes less than 1 in every 200 payments received each year would be subject to the increased penalty.

<u>F. Understatement of Taxpayer's Liability by Tax Return Preparers</u> (Act section 8246 and IRC sections 6694 and 7701)

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

An income tax return preparer is defined as any person who prepares for compensation, or who employs other people to prepare for compensation, all or a substantial portion of an income tax return or claim for refund. Under present law, the definition of an income tax return preparer does not include a person preparing non-income tax returns, such as estate and gift, excise, or employment tax returns.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

An income tax return preparer who prepares a return with respect to which there is an understatement of tax that is due to an undisclosed position for which there was not a realistic possibility of being sustained on its merits, or a frivolous position, is liable for a first-tier penalty of $250, provided the preparer knew or reasonably should have known of the position. For purposes of the penalty, an understatement is generally defined as any understatement with respect to any tax imposed by subtitle A (i.e., income taxes). An income tax return preparer who prepares a return and engages in specified willful or reckless conduct with respect to preparing an income tax return is liable for a second-tier penalty of $1,000.

Explanation of Provision

The SBWOTA broadens the scope of the present-law tax return preparer penalties to include preparers of estate and gift tax, employment tax, and excise tax returns, and returns of exempt organizations.

The provision also alters the standards of conduct that must be met to avoid imposition of the penalties for preparing a return with respect to which there is an understatement of tax. First, the provision replaces the realistic possibility standard for undisclosed positions with a requirement that there be a reasonable belief that the tax treatment of the position was more likely than not the proper treatment. The provision replaces the not-frivolous standard accompanied by disclosure with the requirement that there be a reasonable basis for the tax treatment of the position accompanied by disclosure. The provision also increases the first-tier penalty from $250 to the greater of $1,000 or 50% of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim with respect to which the penalty is imposed. The provision increases the second-tier penalty from $1,000 to the greater of $5,000 or 50% of the income derived (or to be derived) by the tax return preparer.

Effective Date

The provision is effective for tax returns prepared after the date of enactment (May 25, 2007).

<u>Current California Law (R&TC section 19166)</u>

California conforms by reference to IRC section 6694, relating to understatement of taxpayer’s liability by tax preparer, as of the “specified date” of January 1, 2005, with substantial modifications.

California modifies the federal standards of conduct that must be met to avoid imposition of the penalties for preparing a return with respect to which there is an understatement of tax as follows:

- R&TC section 19166(b)(2) replaces the “realistic possibility standard” for undisclosed positions with a requirement that there be a “reasonable belief that the tax treatment in that position was more likely than not the proper treatment."

- R&TC section 19166(b)(3) replaces the "not-frivolous standard" accompanied by disclosure with the requirement that there be a "reasonable basis for the tax treatment of the position" accompanied by disclosure.

Additionally, California modifies the federal first-tier and second-tier penalty amounts as follows:

- R&TC section 19166(b)(1) also increases the first-tier penalty for unrealistic positions from $250 to $1,000 for certain reportable transactions, any listed transaction, or a gross misstatement.
- R&TC section 19166(c) increases the second-tier penalty for willful or reckless conduct from $1,000 to $5,000.

Revenue Impact of Conforming to the Change in Federal Law

Estimated Revenue Impact of SBWOTA of 2007 Effective for Returns Prepared after 6/30/07 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
-	+$750,000	+$750,000

The revenue impact of conforming to the new penalty amounts would depend on the projected level of enforcement activity by the FTB. Based on recently increased staffing levels, the estimated annual revenue yield would likely triple with around $750,000 of additional revenue starting with the 2008-09 fiscal year (applies to returns filed after the date of enactment).

G. Penalty for Filing Erroneous Refund Claims (Act section 8247 and new IRC section 6676)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

IRC section 6662 imposes accuracy-related penalties on a taxpayer in cases involving a substantial valuation misstatement or gross valuation misstatement relating to an underpayment of income tax. The penalty is 20 percent of the underpayment of tax resulting from a substantial valuation misstatement and rises to 40 percent for a gross valuation misstatement. Under present law, no penalty is imposed with respect to any portion of the understatement attributable to any item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there is a reasonable basis for the tax treatment. Special rules apply to tax shelters.

Explanation of Provision

The SBWOTA imposes a new penalty on any taxpayer filing an erroneous claim for refund or credit.

The penalty is equal to 20 percent of the disallowed portion of the claim for refund or credit for which there is no reasonable basis for the claimed tax treatment. The penalty does not apply to any portion of the disallowed portion of the claim for refund or credit relating to the earned income credit or any portion of the disallowed portion of the claim for refund or credit that is subject to accuracy-related or fraud penalties.

Effective Date

The provision is effective for claims for refund or credit filed after the date of enactment (May 25, 2007).

Current California Law (R&TC section 19164)

California conforms by reference to IRC section 6662, relating to imposition of accuracy-related penalty on underpayments, in R&TC section 19164, as of the "specified date" of January 1, 2005, with modifications. California has not conformed to new IRC section 6676, relating to erroneous claim for refund or credit, that was enacted in the SBWOTA.

Revenue Impact of Conforming to the Change in Federal Law

Estimated Revenue Impact of SBWOTA of 2007 Effective for Claims Filed On or After 1/1/08 Enactment Assumed After June 30, 2007		
2007-08	2008-09	2009-10
-	+ < $150,000	+ < $150,000

The estimated revenue impact should California conform to the 20% penalty on erroneous claims would likely not exceed $150,000 annually beginning no earlier than fiscal year 2008-09. The timing of such impact is based on the assumption that minimum length of time to resolve a case involving a potentially erroneous claim is at least six months.

H. Time for Payment of Corporate Estimated Tax (Act section 8248)

Summary of Federal Change from Joint Committee on Taxation Analysis

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Background

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) section 401 provided that in the case of a corporation with assets of at least $1 billion, the payments due in July, August, and September, 2012 (for fiscal and calendar year taxpayers, respectively) are increased to 106.25% of the payment otherwise due and the next required payment is reduced accordingly.

Explanation of Provision

This uncodified provision in the SBWOTA increases the corporate estimated tax payments due in July, August, and September, 2012, from 106.25 percent to 114.25 percent of the payment otherwise due. As under present law, the next payment is reduced accordingly.

Effective Date

The provision is effective on the date of enactment (May 25, 2007).

<u>Current California Law (R&TC sections 19021-19027 and 19142-19151)</u>

California does not conform to TIPRA section 401. Additionally, California does not conform by reference to IRC section 6655, relating to failure by corporation to pay estimated tax, but instead has stand-alone law in Article 2 of Chapter 4 of the R&TC (R&TC sections 19021-19027), relating to the requirement for corporations to make estimated tax payments, and R&TC sections 19142 – 19151, relating to the penalty for underpayment of corporate estimated tax.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

Not applicable.

III. PENSION RELATED PROVISIONS (Chapter 6 of Title VI - Other Matters - of PL 110-28)

<u>A. Revocation of Election Relating to Treatment as Multiemployer Plan</u>
(Act section 6611 and IRC section 414(f))

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

A multiemployer plan means a plan (1) to which more than one employer is required to contribute; (2) which is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer; and (3) which satisfies such other requirements as the Secretary of Labor may prescribe.

Present law provides that within one year after the date of enactment of the Multiemployer Pension Plan Amendments Act of 1980, a multiemployer plan could irrevocably elect for the plan not to be treated as a multiemployer plan if certain requirements were satisfied.

Pursuant to the Pension Protection Act of 2006, certain multiemployer plans are permitted under the Employee Retirement Income Security Act of 1974 (ERISA) and IRC section 414 to revoke an existing election not to treat the plan as a multiemployer plan if, for each of the three plan years prior to the date of enactment, the plan would have been a multiemployer plan, but for the election in place. An election made under the provision is effective beginning with the first plan year ending after the date of enactment of the Pension Protection Act of 2006 (i.e., August 17, 2006) and is irrevocable.

Explanation of Provision

The SBWOTA modifies the effective date of the election provided under ERISA and IRC section 414. Under the provision, a plan may elect an effective date that is any plan year beginning on or after January 1, 1999, and ending before January 1, 2008. The provision also modifies the time period during which the plan must have satisfied the criteria for the election. Under the provision, the criteria must have been satisfied for each of the three plan years immediately preceding the first plan year for which the election is effective with respect to the plan. In addition, the provision provides that a plan making the election is treated as maintained pursuant to a collective bargaining agreement if a collective bargaining agreement, expressly or otherwise, provides for or permits employer contributions to the plan by one or more employers that are signatory to such agreement, or participation in the plan by one or more employees of an employer that is signatory to such agreement.

In addition, the provision makes a technical correction to the description of one of the plans that is eligible to make the election. Specifically, the technical correction provides that an election is available in the case of a plan sponsored by an organization which is described in IRC section 501(c)(5) and exempt from tax under IRC section 501(a) and which was established in Chicago, Illinois, on August 12, 1881.

Effective Date

The provision takes effect as if included in section 1106 of the Pension Protection Act of 2006.

<u>California Law (R&TC sections 17501 and 17551)</u>

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

ERISA Preemption

Federal ERISA provisions apply to pension plans in California. There are no California law provisions because federal law preempts state laws affecting these plans.

IRC Provisions

In general, California conforms by reference to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of IRC sections 401 through 424, inclusive, in R&TC section 17501(a) as of the "specified date" of January 1, 2005. Additionally, California conforms by reference to Subchapter E of Chapter 1 of Subtitle A of the IRC, relating to accounting periods and methods of accounting, consisting of IRC sections 441 through 483, inclusive, in R&TC section 17551(a) as of the "specified date" of January 1, 2005. However, except for increases in the maximum amount of elective deferrals, R&TC sections 17501(b) and 17551(c) specifically provide that federal changes to Part I of Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of IRC sections 401 through 420, inclusive, and IRC section 457, relating to deferred compensation plans of state and local governments and tax-exempt organizations, apply without regard to taxable year to the same extent as applicable for federal income tax purposes and thus adopt all changes made to those IRC sections without regard to the "specified date" contained in R&TC section 17024.5. The federal changes to IRC section 414 made by this provision of the SBWOTA are applicable for California purposes without regard to taxable year to the same extent as applicable for federal income tax purposes.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

ERISA changes result in no conformity revenue impact. Any revenue impact would be considered baseline.

Changes to IRC section 414

Any revenue impact is baseline as California is conformed to the SBWOTA change to IRC section 414.

<u>B. Modification of Requirements for Qualified Transfers</u> (Act sections 6612 and 6613 and IRC section 420)

<u>Summary of Federal Change from Joint Committee on Taxation Analysis</u>

Background

A pension plan may provide medical benefits to retired employees through a separate account that is part of such plan (retiree medical accounts). Generally, defined benefit plan assets may not revert to an employer prior to termination of the plan and satisfaction of all plan liabilities. However, IRC section 420 provides that certain transfers of excess assets of a defined benefit plan to a retiree medical account within the plan may be made in order to fund retiree health benefits. A transfer that qualifies under IRC section 420 does not result in plan disqualification, is not a prohibited transaction, and is not treated as a reversion. No transfer pursuant to IRC section 420 may be made after December 31, 2013.

Prior to the amendment of IRC section 420 by the Pension Protection Act of 2006, transferred assets (and any income thereon) were required to be used to pay qualified current retiree health liabilities for the taxable year of the transfer. Among the requirements for such a transfer to be qualified is the requirement that the employer generally must maintain retiree health benefits at the same level for the taxable year of the transfer and the following four years (referred to as the minimum cost requirement).

Pursuant to changes made by the Pension Protection Act of 2006, IRC section 420 currently permits an employer to elect to make a "qualified future transfer" or a "collectively bargained transfer" rather than a "qualified transfer" (which generally is a transfer described in IRC section 420, prior to amendment by the Pension Protection Act of 2006). A qualified future transfer permits transfers of excess pension assets under a single-employer plan to retiree medical accounts to fund the expected cost of retiree medical benefits for the current and future years. A collectively bargained transfer permits such transfers in the case of benefits provided under a collective bargaining agreement. Transfers must be made for at least a two-year period (referred to as the transfer period). In addition, a qualified future transfer or collectively bargained transfer must meet the requirements applicable to qualified transfers, with certain modifications to the requirements, one of which is the minimum cost requirement.

In the case of a qualified future transfer, the minimum cost requirement is satisfied if, during the transfer period and the four subsequent years, the annual average amount of employer costs is not less than applicable employer cost determined with respect to the transfer. An employer may elect to meet this minimum cost requirement by meeting the requirements as in effect before the amendments made by section 535 of the Tax Relief Extension Act of 1999 for each year during the transfer period and the four subsequent years. In the case of a collectively bargained transfer, the minimum cost requirement is satisfied if each collectively bargained group health plan under which collectively bargained health benefits are provided provides that the collectively bargained employer cost for each taxable year during the collectively bargained cost maintenance period is not less than the amount specified by the collective bargaining agreement. The collectively bargained employer cost is the average cost per covered individual of providing collectively bargained retiree health benefits as determined in accordance with the applicable collective bargaining agreement. Thus, retiree medical benefits must be provided at the level determined under the collective bargaining agreement for the shorter of (1) the remaining lifetime of each covered retiree (and any covered spouse and dependent), or (2) the period of coverage provided under the collectively bargained health plan for such covered retiree (and any covered spouse and dependent).

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

Explanation of Provision

In the case of a qualified transfer, the SBWOTA permits the transfer to satisfy the minimum cost requirement by satisfying the minimum cost requirement applicable to a collectively bargained transfer. This alternate method of satisfying the minimum cost requirement is only available if the transfer involves a plan maintained by an employer, which in its taxable year ending in 2005, provided health benefits or coverage to retirees and their spouses and the aggregate cost of such benefits or coverage which would have been allowable as a deduction to the employer is at least five percent of the gross receipts of the employer for such taxable year (or is a plan maintained by a successor to such employer).

In addition, the provision makes technical corrections to IRC section 420 to correct an internal cross-reference and to reflect the revisions made to the minimum funding requirements applicable to defined benefit plans under the Pension Protection Act of 2006.

Effective Date

The provision is generally effective for transfers after the date of enactment (May 25, 2007). The technical corrections are effective as if included in the Pension Protection Act of 2006.

Current California Law (R&TC sections 17501 and 17551)

In general, California conforms by reference to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of IRC sections 401 through 424, inclusive, in R&TC section 17501(a) as of the “specified date” of January 1, 2005. Additionally, California conforms by reference to Subchapter E of Chapter 1 of Subtitle A of the IRC, relating to accounting periods and methods of accounting, consisting of IRC sections 441 through 483, inclusive, in R&TC section 17551(a) as of the “specified date” of January 1, 2005. However, except for increases in the maximum amount of elective deferrals, R&TC sections 17501(b) and 17551(c) specifically provide that federal changes to Part I of Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of IRC sections 401 through 420, inclusive, and IRC section 457, relating to deferred compensation plans of state and local governments and tax-exempt organizations, apply without regard to taxable year to the same extent as applicable for federal income tax purposes and thus adopt all changes made to those IRC sections without regard to the “specified date” contained in R&TC section 17024.5. The federal changes to IRC section 420 made by this provision of the SBWOTA are applicable for California purposes without regard to taxable year to the same extent as applicable for federal income tax purposes.

Revenue Impact of Conforming to the Change in Federal Law

Any revenue impact is baseline as California is conformed to the SBWOTA change to IRC section 420.

C. Extension of Alternative Deficit Reduction Contribution Rules (Act section 6614, amending Act section 402(i) of the Pension Protection Act of 2006, impacting ERISA section 302 and IRC section 412)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

In the case of an employer which is a commercial passenger airline, the Pension Protection Act of 2006 extends the alternative deficit reduction contribution rules under ERISA to plan years beginning before December 28, 2007.

Explanation of Provision

The SBWOTA extends the alternative deficit reduction contribution rules under ERISA section 302 and IRC section 412 to plan years beginning before January 1, 2008.

Effective Date

The provision takes effect as if included in section 402 of the Pension Protection Act of 2006.

Current California Law (R&TC sections 17501 and 17551)

ERISA Preemption

Federal ERISA provisions apply to pension plans in California. There are no California law provisions because federal law preempts state laws affecting these plans.

IRC Provisions

In general, California conforms by reference to Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of IRC sections 401 through 424, inclusive, in R&TC section 17501(a) as of the "specified date" of January 1, 2005. Additionally, California conforms by reference to Subchapter E of Chapter 1 of Subtitle A of the IRC, relating to accounting periods and methods of accounting, consisting of IRC sections 441 through 483, inclusive, in R&TC section 17551(a) as of the "specified date" of January 1, 2005. However, except for increases in the maximum amount of elective deferrals, R&TC sections 17501(b) and 17551(c) specifically provide that federal changes to Part I of Subchapter D of Chapter 1 of Subtitle A of the IRC, relating to deferred compensation, consisting of IRC sections 401 through 420, inclusive, and

IRC section 457, relating to deferred compensation plans of state and local governments and tax-exempt organizations, apply without regard to taxable year to the same extent as applicable for federal income tax purposes and thus adopt all changes made to those IRC sections without regard to the “specified date” contained in R&TC section 17024.5. The federal changes to IRC section 412 made by this provision of the SBWOTA are applicable for California purposes without regard to taxable year to the same extent as applicable for federal income tax purposes.

Revenue Impact of Conforming to the Change in Federal Law

ERISA changes result in no conformity revenue impact. Any revenue impact would be considered baseline losses to the extent the additional premiums are deducted from AGI by employers/plan sponsors.

IRC Provisions

Any revenue impact is baseline as California is conformed to the SBWOTA change to IRC section 412.

D. Modification of the Interest Rate for Pension Funding Rules (Act section 6615, amending uncodified section 402(a) of the Pension Protection Act of 2006, impacting ERISA *section* 303)

Summary of Federal Change from Joint Committee on Taxation Analysis

Background

Single-employer defined benefit pension plans are subject to minimum funding requirements under ERISA and the IRC. The Pension Protection Act of 2006 provides for new minimum funding rules, which are generally effective for plan years beginning after December 31, 2007.

Under the new minimum funding rules, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan’s assets with the plan’s funding target and target normal cost. The plan’s funding target is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan’s target normal cost for a plan year is the present value of benefits expected to accrue or be earned during the plan year. In general, a plan has a funding shortfall if the plan’s funding target for the year exceeds the value of the plan’s assets (reduced, if applicable, by any prefunding balance and funding standard carryover balance). If the value of a plan’s assets (reduced by any funding standard carryover balance and prefunding balance) is less than the plan’s funding target for a plan year, so that the plan has a funding shortfall, the minimum required contribution is generally increased by a shortfall amortization charge.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

The shortfall amortization charge for a plan year is the aggregate total of the shortfall amortization installments for the plan year with respect to any shortfall amortization bases for that plan year and the six preceding plan years. A shortfall amortization base is generally required to be established for a plan year if the plan has a funding shortfall for a plan year. The shortfall amortization base for a plan year is (1) the plan's funding shortfall, minus (2) the present value, determined using the segment interest rates (discussed below), of the aggregate total of the shortfall amortization installments (and, if applicable, waiver amortization installments) that have been determined for the plan year and any succeeding plan year with respect to any shortfall amortization bases (and waiver amortization bases) for preceding plan years. The shortfall amortization installments with respect to a shortfall amortization base for a plan year are the amounts necessary to amortize the shortfall amortization base in level annual installments over the seven-plan-year period beginning with the plan year. The shortfall amortization installment with respect to a shortfall amortization base for any plan year in the seven-year period is the annual installment determined for that year for that shortfall amortization base. Shortfall amortization installments are determined using the appropriate segment interest rates.

The new minimum funding rules specify the interest rates and other actuarial assumptions that must be used in determining a plan's target normal cost and funding target. Under the rules, present value is determined using three interest rates ("segment" rates), each of which applies to benefit payments expected to be made from the plan during a certain period. The first segment rate applies to benefits reasonably determined to be payable during the five-year period beginning on the first day of the plan year; the second segment rate applies to benefits reasonably determined to be payable during the 15-year period following the initial five-year period; and the third segment rate applies to benefits reasonably determined to be payable the end of the 15-year period. Each segment rate is a single interest rate determined monthly by the Secretary of the Treasury on the basis of a corporate bond yield curve, taking into account only the portion of the yield curve based on corporate bonds maturing during the particular segment rate period. In general, the corporate bond yield curve used for this purpose is to be prescribed on a monthly basis by the Secretary of the Treasury and reflects the average, for the 24-month period ending with the preceding month, of yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. A special transition rule applies for plan years beginning in 2008 and 2009 (other than for plans first effective after December 31, 2007).

In addition to the new minimum funding rules described above, section 402(a) of the Pension Protection Act of 2006 also provided an uncodified provision for special funding rules to apply for certain eligible plans. An eligible plan is a single-employer defined benefit pension plan sponsored by an employer that is a commercial passenger airline or the principal business of which is providing catering services to a commercial passenger airline.

ATTACHMENT 1

Small Business and Work Opportunity Tax Act (SBWOTA) of 2007 (Subtitle B of TITLE VIII of PL 110-28) Enacted May 25, 2007

The plan sponsor of an eligible plan may make one of two alternative elections. In the case of a plan that meets certain benefit accrual and benefit increase restrictions, an election allowing a 17-year amortization of the plan's unfunded liability is available. In lieu of this election, a plan sponsor may alternatively elect, for the first taxable year beginning in 2008, to amortize the shortfall amortization base for such taxable year over a period of 10 plan years (rather than 7 plan years) beginning with such plan year. Under this alternative election, the benefit accrual and benefit increase restrictions do not apply. This 10-year amortization election must be made by December 31, 2007.

Explanation of Provision

The SBWOTA amends the uncodified provision in section 402(a) of the Pension Protection Act of 2006 to provide that, in the case of a plan sponsor that elects to amortize the shortfall amortization base over a period of 10 plan years, the plan is to use an interest rate of 8.25 percent for purposes of determining the funding target for each of the 10 plan years during such period (instead of the segment rates calculated on the basis of the corporate bond yield curve).

Effective Date

The provision takes effect as if included in section 402 of the Pension Protection Act of 2006.

<u>Current California Law</u>

ERISA Preemption

Federal ERISA provisions apply to pension plans in California. There are no California law provisions because federal law preempts state laws affecting these plans.

<u>Revenue Impact of Conforming to the Change in Federal Law</u>

ERISA changes result in no conformity revenue impact. Any revenue impact would be considered baseline losses to the extent the additional premiums are deducted from AGI by employers/plan sponsors.

ATTACHMENT 2
Revenue Table

Table 1 – Conformity Revenue Estimates for Small Business and Work Opportunity Tax Act of 2007 (PL 110-28) Assumed Enactment After June 30, 2007				
		State Revenue Impact		
Act Section	**Provisions**	**2007-08**	**2008-09**	**2009-10**
8211	Extension and modification of the work opportunity tax credit ("WOTC")	N/A	N/A	N/A
8212	Increase and extension of expensing for small business	N/A	N/A	N/A
8213	Determination of credit for certain taxes paid with respect to employee cash tips	N/A	N/A	N/A
8214	Waiver of individual and corporate alternative minimum tax limits on work opportunity credit and credit for taxes paid with respect to employee cash tips	N/A	N/A	N/A
8215	Family business tax simplification	- < $150,000	- < $150,000	- < $150,000
8221	One-year extension to special increase in expensing under section 179 for GO Zone property	N/A	N/A	N/A
8222	Extension and expansion of low-income housing credit rules for buildings in the GO Zones	N/A	N/A	N/A
8223	Special tax-exempt bond financing rule for repairs and reconstructions of residences in the GO Zones	N/A	N/A	N/A
8224	GAO study of certain tax incentives in the GO Zones	N/A	N/A	N/A
8231	Exclude S Corporation capital gains from passive investment income	Baseline	Baseline	Baseline
8232	Treatment of qualifying director shares	Baseline	Baseline	Baseline
8233	Recapture of bad debt reserves	+$1,000,000	- < $250,000	-$1,000,000
8234	Treatment of sale of interest in a qualified subchapter S subsidiary	- < $150,000	- < $150,000	- < $150,000
8235	Elimination of all earnings and profits attributable to pre-1983 years	N/A	N/A	N/A
8236	Permit interest deduction to an electing small business trust to acquire S corporation stock	- < $150,000	- < $150,000	- < $150,000
8241	Increase in Age of Minor Children Whose Unearned Income is Taxed as if Parent's Income	+ $1,000,000	+ $4,000,000	+ $6,000,000

ATTACHMENT 2
Revenue Table

8242	Modify interest suspension under 6404(g) from 18 to 36 months	--	+ $7,000,000	+ $7,000,000
8243	Modification of collection due process procedures for employment tax liabilities	Defer to EDD	Defer to EDD	Defer to EDD
8244	Permanent extension of IRS user fees	N/A	N/A	N/A
8245	Increase in penalty for bad checks and money orders	+ < $500,000	+ < $500,000	+ < $500,000
8246	Understatement of taxpayer liability by return preparers	--	+ < $750,000	+ < $750,000
8247	Penalty for filing erroneous refund claims	--	+ < $150,000	+ < $150,000
8248	Increase corporate estimated tax payments due July through September for corporations with assets of $1 billion in 2012	N/A	N/A	N/A
6611	Revocation of election relating to treatment as multi-employer plan	Baseline	Baseline	Baseline
6612	Modification of requirements for qualified transfers	Baseline	Baseline	Baseline
6614	Extension of alternative deficit reduction contribution rules	Baseline	Baseline	Baseline
6615	Modification of the interest rate for pension funding rules	Baseline	Baseline	Baseline

[1] For baseline estimates see individual section write-ups