



## **Analysis of Amended Bill**

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Sponsor:

Bill Number: AB 217

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Amended: June 13, 2019

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Related Bills: See Legislative  
History

**Subject:** Loophole Closure and Small Business and Working Families Tax Relief Act of 2019

### **Summary**

This bill would do the following:

Provision No. 1: Modify the California Earned Income Tax Credit (California EITC)

Provision No. 2: Create the Young Child Tax Credit (as an enhancement to the California EITC)

Provision No. 3: Conform to the Achieving a Better Life Experience (ABLE) Accounts Increased Contributions and Internal Revenue Code (IRC) section 529 Account Rollovers

Provision No. 4: Conform to the Death and Disability Exclusion for Cancellation of Indebtedness of Student Loans

Provision No. 5: Conform to Disallowance of the Federal Deposit Insurance Corporation (FDIC) Premiums Deduction

Provision No. 6: Conform to the Limitation of a Deduction for Excessive Employee Remuneration

Provision No. 7: Eliminate Net Operating Loss (NOL) Carrybacks

Provision No. 8: Conform to the Small Business Accounting Method Changes

Provision No. 9: Modified Conformity to the Loss Limitations for Non-Corporate Taxpayers

Provision No. 10: Conform to the Repeal of Technical Partnership Termination

Provision No. 11: Modified Conformity to the Limitation on Like-Kind Exchanges to Real Property

Provision No. 12: Disallowance of Separate State IRC Section 338 Elections

### Summary of Amendments

The June 13, 2019, amendments removed provisions from the Food and Agriculture Code, the Health and Safety Code, and the Water code, and have been replaced with the provisions discussed in this analysis.

This is the department's first analysis of this bill.

### Recommendation – No position.

### Reason for the Bill

The reason for this bill is to reduce California poverty by increasing the number of Californians eligible for the California EITC, and to provide tax relief to small businesses.

### Effective/Operative Date

As an urgency measure, this bill would be effective immediately upon enactment. This bill is operative immediately upon enactment, except where the operative dates of the provisions provide otherwise. The operative dates of the provisions vary and are addressed separately below.

### Economic Impact – Summary Revenue Table (\$ in Millions)

Fiscal Year	2018-2019	2019-2020	2020-2021	2021-2022
Provision 1: California EITC	n/a	-\$240	-\$230	-\$220
Provision 2: Young Child Tax Credit	n/a	-\$360	-\$360	-\$360
Provision 3: ABLE Accounts	n/a	-\$0.8	-\$0.45	-\$0.45
Provision No. 4: Exclusion for student law indebtedness	n/a	-\$0.7	-\$0.5	-\$0.5
Provision No5. Limitation FDIC Premium Deduction	n/a	+\$65	+\$55	+\$50

<b>Fiscal Year</b>	<b>2018-2019</b>	<b>2019-2020</b>	<b>2020-2021</b>	<b>2021-2022</b>
Provision No. 6: Limitation of Excessive Employee Remuneration	n/a	+\$32	+\$29	+\$29
Provision No. 7: Eliminate NOL carrybacks	+\$360	+\$200	+\$190	+\$190
Provision No.8: Small Business Accounting Method Changes	-\$180	-\$280	-\$110	-\$65
Provision No. 9: Limit Losses for Non Corporate Taxpayers, modified conformity	n/a	+\$1,300	+\$850	+\$900
Provision No. 10: Partnership Termination	+\$3.7	+\$10	+\$5.3	+\$7.7
Provision No. 11: Limitation on Like-Kind Exchanges to Real Property	n/a	+\$240	+\$200	+\$180
Provision No. 12: Adopt Federal IRC Section 338 Elections	n/a	+\$38	+\$60	+\$60
Total \$ in Millions	+\$183.7	+\$1,003.5	+ \$688.35	+ \$770.75

**Provision No. 1:** California EITC (Section 2.)

**Effective/Operative Date**

The modifications to the California EITC made by this provision would be specifically operative for taxable years beginning on or after January 1, 2019.

**Program Background**

California began offering its own California EITC starting with the 2015 tax returns. This refundable tax credit puts money back in the pockets of California's working families and individuals. For taxpayers who owe taxes, the California EITC reduces the amount of taxes they might owe and may allow them a refund when they file their taxes. If

they do not owe taxes, the California EITC will provide them a tax refund when they file their taxes.

To claim the California EITC, eligible taxpayers must file their California personal income tax return and attach Form 3514, *California Earned Income Tax Credit*.

## Analysis

### Federal/State Law

Existing federal law (IRC section 32) allows eligible individuals a refundable Earned Income Tax Credit (EITC). A refundable credit allows for the excess of the credit over the taxpayer's tax liability to be refunded to the taxpayer. The EITC is a percentage of the taxpayer's earned income and is phased out as income increases. For 2018, the EITC is available to individuals and families earning up to \$54,884. The federal credit rate varies from 7.65 percent to 45 percent, depending on the number of qualifying children.<sup>1</sup>

An eligible individual<sup>2</sup> is defined as follows:

- Any individual who has a qualifying child for the taxable year, or
- Any other individual that does not have a qualifying child for the taxable year, if they meet the following requirements:<sup>3</sup>
  - Have attained the age of 25 but not attained the age of 65 before the close of the taxable year.
  - Have a principal place of abode in the United States for more than one-half the taxable year.
  - Not be a dependent of another taxpayer.

An eligible individual (and spouse, if filing a joint return) also must have a Social Security Number (SSN) issued by the Social Security Administration that is valid for employment.<sup>4</sup>

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<sup>1</sup> The maximum credit ranges from \$519 for an eligible individual without a qualifying child up to \$6,431 for an eligible individual with three or more qualifying children.

<sup>2</sup> IRC section 32(c)(1).

<sup>3</sup> IRC section 32(c)(1)(A)(ii).

<sup>4</sup> IRC section 32(m). The SSN must be issued by the Social Security Administration and must be valid for employment. A social security card stating "Not Valid for Employment" or a federal individual taxpayer identification number (ITIN) may not be used for the federal EITC.

Certain individuals are specifically excluded from the definition of an eligible individual.<sup>5</sup>

Generally, a qualifying child must live with the eligible individual for more than one-half the taxable year in the United States, and must be under the age of 19, unless the child is a full-time student under age 24, or the child is permanently and totally disabled. Only one person can claim a qualifying child.

The name, age, and SSN of the qualifying child must be reported on the tax return.

State law provides a refundable California EITC that is generally determined in accordance with IRC section 32, as applicable for federal income tax purposes for the taxable year, except as modified.<sup>6</sup>

State law conforms to the federal definitions of an “eligible individual” and a “qualifying child” with the following exceptions:

- An eligible individual without a qualifying child must have a principal place of abode in “this state” (rather than the United States) for more than one-half of the taxable year, and for taxable years beginning on or after January 1, 2018, may have reached the age of 18 by the close of the taxable year (rather than have attained the age of 25 but not attained the age of 65 before the close of the taxable year).
- A qualifying child also must have a principal place of abode in “this state” (rather than the United States) for more than one-half of the taxable year.

State law conforms to the federal requirement that an eligible individual and any qualifying child must have a valid SSN.

For purposes of the California EITC, the federal definition of “earned income” is modified to include wages, salaries, tips, and other employee compensation, includable in federal Adjusted Gross Income (AGI), but only if such amounts are subject to California withholding.<sup>7</sup>

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<sup>5</sup> IRC section 32(c)(1) excludes from the definition of an eligible individual: an individual who is a qualifying child of another taxpayer; U.S. citizens or residents living abroad and claiming benefits under IRC section 911, and most nonresident aliens, unless they elect to be treated as US residents for federal tax purposes.

<sup>6</sup> Revenue and Taxation Code (R&TC) section 17052. The California EITC is only operative for taxable years the annual Budget Act specifies an adjustment factor and authorizes resources for the Franchise Tax Board (FTB) to oversee and audit returns associated with the California EITC. Refunds for the California EITC are paid from the continuously appropriated Tax Relief and Refund Account. For additional details on the California EITC, refer to the [Franchise Tax Board home page](http://www.ftb.ca.gov) at www.ftb.ca.gov.

<sup>7</sup> Pursuant to Division 6 (commencing with section 13000) of the Unemployment Insurance Code.

For taxable years beginning on or after January 1, 2018, the California EITC was modified to increase the maximum AGI amounts at which the California EITC is completely phased-out.

For 2018, the California EITC is generally available to households with AGI of up to \$16,750 if there are no qualifying children, and up to \$24,950 if there is one or more qualifying children.

### **This Provision**

For taxable years beginning on or after January 1, 2019, this provision, under the Personal Income Tax Law (PITL), would modify the California EITC by increasing the maximum AGI limits to \$30,000 for an eligible individual with a qualifying child or without a qualifying child. To accomplish the increase in the maximum AGI limit, this provision would provide two new tables: 1) the credit and phaseout percentage table, and 2) the earned income and phaseout amount table. The \$30,000 maximum AGI limit would be increased by the percentage change as calculated under R&TC section 17041(h) for any taxable year, and the following taxable years, in which the minimum wage is set at fifteen dollars an hour.

Additionally, this provision would specify that for taxable years beginning on or after January 1, 2019, and before January 1, 2020, the percentage change in the California Consumer Price Index (CCPI) would be deemed to be the greater of 3.5 percent or the percentage change in the CCPI as calculated under R&TC section 17041(h) for that taxable year.

### **Implementation Considerations**

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

### **Legislative History**

AB 91 (Burke, et al., 2019/2020), substantially similar to this bill, would modify the California EITC, create the Young Child Tax Credit, and make a number of changes conforming to Federal law. AB 91 is enrolled.

SB 855 (Committee on Budget and Fiscal Review, Chapter 52, Statutes of 2018) increased the maximum AGI limits and for an eligible individual without a qualifying child change modified the age requirement.

AB 131 (Assembly Committee on Budget, Chapter 252, Statutes of 2017) provided technical clarification to previous budget trailer bills related to the 2017 Annual Budget Act, including SB 106 discussed below.

AB 1942 (Santiago, 2017/2018), would have required the FTB to modify the Form 540 related to the California EITC, and modify *The EITC Information Act*. AB 1942 was held in the Assembly Appropriations Committee.

SB 106 (Senate Committee on Budget and Fiscal Review, Chapter 96, Statutes of 2017), expanded the California EITC by modifying the earned income computation to include net earnings from self-employment, consistent with federal law, and increasing the maximum AGI phase-out amounts.

SB 1073 (Monning, Chapter 722, Statutes of 2016) made permanent the enhanced 45-percent credit rate for three or more qualifying children to be consistent with the federal EITC.

SB 80 (Senate Committee on Budget and Fiscal Review, Chapter 21, Statutes of 2015) enacted the California EITC.

### **Other States' Information**

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Illinois* allows taxpayers to claim a refundable credit equal to 18 percent of their federal EITC.

*Massachusetts* allows taxpayers to claim a refundable credit based on their federal EITC. Beginning with taxable year 2019, the credit percentage increases from 23 to 30 percent.

*Michigan* allows taxpayers to claim a refundable credit equal to 6 percent of their federal EITC.

*Minnesota* generally allows taxpayers to claim a Working Family Credit (WFC) if they are eligible for the federal EITC. A taxpayer without a qualifying child who is between the age of 21 and 64, and otherwise eligible for the federal EITC, may also receive the WFC. The WFC is based on the lesser of the federal EITC or federal AGI.

*New York* allows taxpayers to claim a refundable credit equal to 30 percent of the federal EITC.

### **Fiscal Impact**

This provision would not significantly impact the department's costs.

## Economic Impact

### Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$240
2020-2021	-\$230
2021-2022	-\$220

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 2:** Young Child Tax Credit (Section 3.)

### Effective/Operative Date

This provision, creating the Young Child Tax Credit, is specifically operative for taxable years beginning on or after January 1, 2019.

### Analysis

#### Federal/State Law

Refer to Provision 1 above.

#### This Provision

For taxable years beginning on or after January 1, 2019, this provision, under the PITL, would create the refundable Young Child Credit for a qualified taxpayer, as specified. The credit amount would be limited to \$1,176 multiplied by the earned income tax credit adjustment factor for the taxable year specified for section 17052. The maximum credit would be limited to \$1,000 per taxable year.

The credit amount would be reduced by \$20 for every \$100 by which the qualified taxpayer's earned income exceeds the threshold amount, initially set at \$25,000. For taxable years after the minimum wage as defined by Section 1182.12 of the Labor Code is set at \$15 per hour, the threshold amount would be recomputed annually in the same manner as the income tax brackets under subdivision (h) of section 17041.



This provision would define the following terms and phrases:

- “Qualified taxpayer” means an eligible individual who has been allowed a tax credit under section 17052 (California EITC), and has at least one qualifying child.
- “Qualifying child” would have the same meaning as under Section 17052, except that the child shall be younger than six years old as of the last day of the taxable year.

The FTB could prescribe rules, guidelines, procedures, or other guidance to carry out the purposes of this section. The rules, guidelines, procedures, and guidance would be exempt from the Administrative Procedure Act (APA).

This provision would specify that for purposes of R&TC section 41, the purpose of the Young Child Tax Credit is to reduce poverty among California's poorest working families and young children. To measure whether the credit achieves its intended purpose, the FTB would be required to annually prepare a written report on the following:

- The number of tax returns claiming the credit.
- The number of qualifying children represented on tax returns claiming the credit.
- The average credit amount on tax returns claiming the credit.

The FTB would be required to provide the written report to the Senate Committee on Budget and Fiscal Review, the Assembly Committee on Budget, the Senate and Assembly Committees on Appropriations, the Senate Committee on Governance and Finance, the Assembly Committee on Revenue and Taxation, and the Senate and Assembly Committees on Human Services.

### **Implementation Considerations**

Implementing this provision would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

### **Legislative History**

Refer to Provision 1 above.

### **Other States' Information**

Refer to Provision 1 above.

### **Fiscal Impact**

This provision would not significantly impact the department's costs.

## Economic Impact

### Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	-\$360
2020-2021	-\$360
2021-2022	-\$360

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision Nos. 3 through 12:** California Conformity to specified federal provisions. All provisions with the exception of Provision No. 12 are from recent Federal Legislation. The Federal Tax Cuts and Jobs Act (Public Law 115-97) and the Consolidated Appropriations Act of 2016 (Public Law 114-113):

See the FTB's annual reports titled, "Summary of Federal Income Tax Changes, 2017."  
<https://www.ftb.ca.gov/about-ftb/data-reports-plans/2017-summary-of-federal-income-tax-changes.pdf>

- Provision No. 3: ABLE Accounts Increase Contributions and 529 Rollovers
- Provision No. 4: Exclusion for Student Loan Indebtedness
- Provision No. 5: Limitation on Federal Deposit Insurance Corporation (FDIC) Premiums Deduction
- Provision No. 6: Limitation of Excessive Employee Remuneration
- Provision No. 7: Eliminate NOL Carrybacks
- Provision No. 8: Small Business Accounting Method Changes
- Provision No. 9: Limit Losses for Non Corporate Taxpayers, Modified Conformity
- Provision No. 10: Conform to the Repeal of Technical Partnership Termination
- Provision No. 11: Limitation on Like-Kind Exchanges to Real Property
- Provision No. 12: IRC Section 338 Elections (not included in the Federal Tax Cuts and Jobs Act)

**Provision No. 3:** ABLE Accounts Increase Contributions and 529 Rollovers. (Sections 4, 5, 6, 20, 21 & 37.)

### **Effective/Operative Date**

This provision would be operative for taxable years beginning on or after January 1, 2019. The bill would specify that eliminating differences in the qualification criteria for ABLE accounts constitutes a public purpose and is not a prohibited gift of public funds within the meaning of Section 6 of Article XVI of the California Constitution.

### **Analysis**

#### **Federal/State Law**

Generally, California law conforms to the IRC as of January 1, 2015. However, there are continuing differences between California and federal law. California conforms to federal tax law changes, with modification. California has yet to conform to the Federal Tax Cuts and Jobs Act (TCJA) (Public Law 115-97).

Existing state and federal laws provide for qualified tuition programs, also known as IRC section 529 accounts, as well as ABLE accounts, also known as IRC section 529A accounts. Both are tax-favored savings programs. An IRC section 529 plan account is a tax-advantaged investment vehicle in the United States designed to encourage saving for the future higher education expenses of a designated beneficiary. An ABLE account is a tax-advantaged investment vehicle in the United States designed to encourage saving for the account beneficiary's qualified disability expenses.

Federal law, under the provisions of the TCJA, temporarily allows amounts from an IRC section 529 account to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that IRC section 529 account, or a member of such designated beneficiary's family. Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year.

Current state law conforms to IRC sections 529 and 529A, as of the "specified date" of January 1, 2015, with modifications. California has not conformed to the modifications of IRC 529 and ABLE accounts made by the TCJA.

**This Provision**

This provision would conform, with modifications, to some of the amendments to IRC sections 529 and 529A made by the TCJA. More specifically, this provision conforms to the allowance of rollovers between IRC section 529 accounts and between section 529 account and ABLÉ accounts.

In order to maintain account qualification for the ABLÉ program and the IRC section 529 qualified tuition program, the language also would conform to IRC section 529A and section 529 changes made by the Consolidated Appropriations Act, 2016 (Division Q, Protecting Americans from Tax Hikes (PATH) Act). More specifically, this provision conforms to the revision to the definition of qualified educational expenditures allowing computer equipment, software, and internet expenses if primarily used by the beneficiary while enrolled at an eligible educational institution, conforms to the allowance of recontributions of refunded amounts, and conforms to the elimination of the residency requirement for qualified ABLÉ programs.

The provision specifically does not conform to Section 11032 of the TJCA, which would provide account funding for primary and secondary education, while it maintains IRC section 529 account qualification for any distributions made pursuant to Section 11032 of the TCJA, and clarifies the California tax treatment of distributions made under the Section 11032 amendments. So while under federal law tax free distributions can be made for payments of primary and secondary school tuition, those distributions are currently taxable under California law and would remain so under this provision. However, such distributions would not disqualify the plan for California purposes.

**Economic Impact**

Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	-\$0.8
2020-2021	-\$0.45
2021-2022	-\$0.45

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 4:** Exclusion for Student Loan Indebtedness (Section 7)

**Effective/Operative Date**

This provision would be specifically operative for taxable years beginning after December 31, 2018.

**Analysis**

**Federal/State Law**

For discharges of indebtedness after December 31, 2017, and before January 1, 2026, certain student loans that are discharged on account of death or total and permanent disability of the student are also excluded from gross income.

California generally conforms to IRC 108(f), the federal treatment of student loan cancellation or repayment, except California has yet to conform to the TCJA's federal exclusion from gross income due to death or total and permanent disability of the student.

**This Provision**

This provision would conform, with modifications, to the federal treatment of student loan cancellation that are discharged on account of death or total and permanent disability of the student for discharges of indebtedness after December 31, 2018.

**Economic Impact**

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	-\$0.7
2020-2021	-\$0.5
2021-2022	-\$0.5

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 5:** Limitation on FDIC Premiums Deduction (Sections 8 & 23)

**Effective/Operative Date**

The limitation of FDIC premium deduction would be operative for taxable years beginning on or after January 1, 2019.

**Analysis**

**Program Background**

FDIC premiums

The FDIC provides deposit insurance for banks and savings institutions. To maintain its status as an insured depository institution, a bank must pay semiannual assessments into the deposit insurance fund (DIF). Assessments for deposit insurance are treated as ordinary and necessary business expenses. These assessments, also known as premiums, are deductible once the all events test for the premium is satisfied.

**Federal/State Law**

For taxable years beginning after December 31, 2017, no deduction is allowed for the applicable percentage of any FDIC premium paid or incurred by certain large financial institutions. The term “applicable percentage” means, for any taxpayer for any tax year, the ratio (expressed as a percentage) that the excess of the taxpayer's total consolidated assets over \$10 billion bears to \$40 billion. The applicable percentage cannot exceed 100 percent, and the disallowance provision does not apply if the taxpayer's total consolidated assets of as of the close of the tax year do not exceed \$10 billion.

California has yet to conform to the TCJA limitations related to the deductibility of FDIC premiums.

**This Provision**

This provision would conform, with modifications, to the federal limitation on the FDIC premium deduction, as made by the TCJA.

Article 9 (commencing with Section 23361) of Chapter 2 of Part 11 of the California R&TC would not apply for the purposes of the FDIC premium deduction limitation.

## Economic Impact

### Revenue Estimate

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended on June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	+\$65
2020-2021	+\$55
2021-2022	+\$50

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 6:** Limitation of Excessive Employee Remuneration (Sections 9 & 22)

### Effective/Operative Date

This provision would be operative for taxable years beginning on or after January 1, 2019.

### Analysis

#### Federal/State Law

For taxable years beginning after December 31, 2017, the exceptions to the \$1 million deduction limitation for commissions and performance-based compensation are repealed. The definition of "covered employee" is revised to include the principal executive officer, the principal financial officer, and the three other highest paid officers. If an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years.

Under a transition rule, the changes do not apply to any remuneration under a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect after that date.

Current state law generally conforms, under the PITL and the Corporation Tax Law (CTL) , to federal law on the deductibility of excessive employee remuneration as of the "specified date" of January 1, 2015, thus has California has yet to conform to the federal TCJA excessive employee remuneration modifications.

**This Provision**

This provision would conform, with modifications, to the TJCA's modifications to the deduction limitation on excess employee remuneration. However, the modifications will not apply to remuneration provided pursuant to a written binding contract which was in effect on March 31, 2019.

**Economic Impact**

Revenue Estimate

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended on June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	+\$32
2020-2021	+\$29
2021-2022	+\$29

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 7:** Eliminate NOL carrybacks (Sections 10, 11, 12, 19, 24, 25, & 26)

**Effective/Operative Date**

This provision is operative for taxable years beginning after December 31, 2018.



## Analysis

### Federal/State Law

For NOLs arising in taxable years ending after December 31, 2017, the two-year carryback and the special carryback provisions are repealed, but a two-year carryback applies in the case of certain losses incurred in the trade or business of farming.

For losses arising in tax years beginning after December 31, 2017, the NOL deduction is limited to 80 percent of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and, except as provided below, NOLs can be carried forward indefinitely.

NOLs of property and casualty insurance companies can be carried back two years and carried over 20 years to offset 100 percent of taxable income in such years.

### This Provision

This provision disallows NOL carrybacks under the PITL and CTL, with limited exceptions, for NOLs attributable to taxable years beginning after December 31, 2018.

This provision also disallows the special rules under IRC section 172 for REITs, excess interest losses, and corporate equity reduction interest losses.

In addition, this provision repeals conformity to IRC section 6164, related to the allowance of an extension of time for payment of taxes by corporations expecting NOL carrybacks.

### Economic Impact

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2018-2019	+\$360
2019-2020	+\$200
2020-2021	+\$190
2021-2022	+\$190

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 8:** Small Business Accounting Method Changes (Sections 14, 15, 27, 29, 30, 31, 32, & 33).

### **Effective/Operative Date**

The operative dates for the various Small Business Accounting Method Changes are for taxable years beginning on or after January 1, 2019. Upon request by the taxpayer, the operative dates can be retroactively applied to taxable years beginning on or after January 1, 2018 and before January 1, 2019. The bill specifies that the provision constitutes a public purpose and is not a prohibited gift of public funds within the meaning of Section 6 of Article XVI of the California Constitution.

### **Analysis**

#### **Federal/State Law**

##### Definition of Small Business

Prior to the TJCA, a small business was defined in IRC section 448 as a taxpayer, other than a tax shelter, whose average annual gross receipts did not exceed \$5 million. For taxable years beginning after December 31, 2017, the TJCA expanded to the definition of a small business to generally include taxpayers whose average annual gross receipts, over three years, did not exceed \$25 million (indexed for inflation for taxable years beginning after December 31, 2018).

##### Cash vs. Accrual Method of Accounting

For taxable years beginning after December 31, 2017, the cash method of accounting may be used by taxpayers (other than tax shelters) who meet the definition of a small business. If a taxpayer meets the definition of a small business under the gross receipts test, the taxpayer is allowed to use the cash method of accounting instead of the accrual method of accounting. This method is also allowed for corporations engaged in farming, however, the modifications do not apply to their existing suspense accounts.

The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations are retained. Accordingly, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the \$25 million gross receipts test, so long as the use of the method clearly reflects income.

### Small Business Exception from Uniform Capitalization (UNICAP) Rules

UNICAP rules, under IRC section 263A, require that taxpayers either include in inventory or capitalize certain costs allocable to real or personal tangible property created by the taxpayer. For taxable years beginning after December 31, 2017, any taxpayer that meets the definition of a small business, as discussed above, is exempt from the UNICAP rules under IRC section 263A.

### Accounting for Inventories

Prior to the TJCA, taxpayers were required to account for inventories when they have production, costs of goods sold, or purchasing as part of their income producing activity. For taxable years beginning after December 31, 2017, small businesses, as discussed above, are excluded from the inventory accounting rules and may choose a permissible, alternative method of accounting for inventories.

### Percentage of Completion Method for Long-Term Contracts

Prior to the TJCA, taxpayers were required to use the Percentage of Completion Method to account for any contract for the manufacture, building, installation or construction where the contract would not be completed in the year in which the contract was entered into. For taxable years beginning after December 31, 2017, small businesses, as discussed above, are exempt for the requirement to use the Percentage of Completion Method of accounting for any construction contract if the contract is estimated to be completed within two years for the date the contract was entered into.

California, under the PITL and the CTL, generally conforms to these federal rules as of the "specified date" of January 1, 2015. California has not conformed to the definition of a small business as expanded by the TCJA nor any of the provisions that provide special rules or exemptions allowed for small businesses.

### **This Provision**

This provision would generally conform to the TJCA's revised definition of small business for method of accounting rules as well as the small business exceptions for UNICAP rules, inventory accounting, and accounting for long term contract rules. In addition, a taxpayer may elect to apply the provision regarding accounting for long term contracts to contracts entered into on or after January 1, 2018, in taxable years ending after January 1, 2018.

Any change in method of accounting made pursuant to this provision shall be treated for purposes of applying Section 481 of the IRC, as applicable for California purposes under Section 17551, as initiated by the taxpayer and made with the consent of the FTB.

## Economic Impact

### Revenue Estimate

This provision would result in the following revenue loss:

Estimated Revenue Impact of AB 217 as Amended on June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2018-2019	-\$180
2019-2020	-\$280
2020-2021	-\$110
2021-2022	-\$65

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 9:** Excess Business Loss Limitations for Non Corporate Taxpayers (Section 13)

### Effective/Operative Date

This provision is operative for taxable years beginning after December 31, 2018.

### Analysis

#### Federal/State Law

For taxable years beginning after December 31, 2017, and before January 1, 2026, the excess farm loss limitation doesn't apply and a noncorporate taxpayer's "excess business loss" is disallowed. Under the new rule, excess business losses are disallowed for the taxable year and are carried forward and treated as part of the taxpayer's NOL carryforward in subsequent taxable years. This limitation applies after the application of the passive loss rules described above.

An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to the taxpayer's trades and businesses, over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount. The threshold amount for a tax year is \$500,000 for married individuals filing jointly, and \$250,000 for other individuals, with both amounts indexed for inflation.

### **This Provision**

This provision would generally conform to the applicable TJCA section with regard to excess business losses with modifications for taxable years beginning after December 31, 2018.

This provision modifies the TJCA section treatment of excess business losses carryforwards. This provision will treat any disallowed excess business loss as a "carryover excess business loss" for the following taxable year as opposed to an NOL carryforward. Taxpayers will be allowed to include any "carryover excess business loss" into their calculation of excess business loss in the following tax year.

### **Economic Impact**

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	+\$1,300
2020-2021	+\$850
2021-2022	+\$900

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 10:** Technical Termination of a Partnership (Section 16)

### **Effective/Operative Date**

This provision is operative for taxable years beginning on or after January 1, 2019. A taxpayer may elect for this provision to be operative for taxable years beginning after December 31, 2017, and before January 1, 2019.

The bill provides that the provision serves a public purpose and does not constitute a prohibited gift of public funds within the meaning of Section 6 of Article XVI of the California Constitution.

## Analysis

### Federal/State Law

Prior to the TJCA, if, in a twelve month period, there was a sale or exchange of 50 percent or more of the total interest in partnership capital or profits, the partnership was treated as if it was technically terminated. Furthermore, a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. For taxable years beginning after December 31, 2017, the IRC section providing for a technical termination of a partnership is repealed. The repeal doesn't change the prior law rule that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

### This Provision

This provision would conform to the TJCA's repeal of the technical termination of a partnership for taxable years beginning on or after January 1, 2019. A partnership may elect to have the repeal of the technical termination apply for taxable years beginning after December 31, 2017, and before January 1, 2019, in a manner determined by the FTB.

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended on June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2018-2019	+\$3.7
2019-2020	+\$10
2020-2021	+\$5.3
2021-2022	+\$7.7

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual

**Provision No. 11:** Limitation on Like-Kind Exchanges (Sections 17, 18, 34 & 35)

**Effective/Operative Date**

This provision is operative for taxable years beginning after December 31, 2018, for exchanges completed after January 10, 2019.

This provision shall not apply to an exchange where the property to be disposed of by the taxpayer in the exchange is disposed of by that taxpayer on or before January 10, 2019, or where the property to be received by the taxpayer in the exchange is received by that taxpayer on or before January 10, 2019.

**Analysis**

**Federal/State Law**

Generally effective for like-kind exchanges after December 31, 2017, property eligible for like-kind exchanges are limited to real property that is not held primarily for sale. However, under a transition rule, the prior law like-kind exchange rules apply to exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

In addition, under the TJCA provision, the special rules under IRC section 1031 (i), relating to mutual ditch, reservoir, or irrigation company stock, were repealed.

**This Provision**

This provision would generally conform with modifications to the TJCA's modifications with respect to like-kind exchanges.

However, with respect to individuals, this provision only applies to:

1. A taxpayer who is a head of household, a surviving spouse, or spouses filing a joint return with adjusted gross income, as defined in Section 17072, of five hundred thousand dollars (\$500,000) or more for the taxable year in which the exchange begins; or
2. For any other taxpayer with adjusted gross income, as defined in Section 17072, of two hundred fifty thousand dollars (\$250,000) or more for the taxable year in which the exchange begins.

If a taxpayer does not meet one of the qualifications described above, the pre-TJCA IRC section 1031 like-kind exchange rules, unless otherwise modified by the R&TC, would continue to apply.

## Economic Impact

### Revenue Estimate

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended on June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

Fiscal Year	Revenue
2019-2020	+\$240
2020-2021	+\$200
2021-2022	+\$180

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

**Provision No. 12:** Disallowance of a Separate State IRC Section 338 Election (Section 28)

### Effective/Operative Date

This provision is operative for taxable years on or after the effective date of this section for acquisitions made on or after the effective dates of this section.

### Analysis

#### Federal/State Law

IRC section 338 allows taxpayers to elect to treat certain qualified stock purchases as asset acquisitions for federal income tax purposes. This section was not amended by the TCJA.

Under R&TC section 23051.5, if a taxpayer makes an election for federal purposes, in which California conforms to the underlying election, the election is treated as being made for California tax purposes as well. Likewise, if a taxpayer does not make an election for federal purposes, the election is treated as having not been made for California tax purposes. However, unless otherwise prohibited, the taxpayer may choose to make a separate election for California tax purposes apart from their federal election treatment.



### **This Provision**

This provision requires taxpayers to use their federal IRC section 338 election treatment for California tax purposes under RTC section 23051.5. Thus, where a taxpayer has made, or has not made, an election under IRC section 338 for federal tax purposes, this provision would require for the taxpayer to make the same election, or not make the election, for California tax purposes.

### **Economic Impact**

#### Revenue Estimate

This provision would result in the following revenue gain:

Estimated Revenue Impact of AB 217 as Amended June 13, 2019  
Assumed Enactment after June 30, 2019

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2019-2020	+\$38
2020-2021	+\$60
2021-2022	+\$60

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

### **Implementation Considerations**

Implementing the conformity provisions would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

### **Legislative History**

AB 91 (Burke, et al., 2019/2020), substantially similar to this bill, would conform with modification to specified provisions of the Federal TCJA (PL 115-97) and would require taxpayers to use their federal IRC section 338 election treatment for California tax purposes. AB 91 is enrolled.

AB 154 (Ting, Chapter 359, Statutes of 2015) changed California's general "specified date" of conformity to federal income tax laws from January 1, 2009, to January 1, 2015, for taxable years beginning on or after January 1, 2015, and generally conformed to the federal NOL rules that allow corporations expecting an NOL carryback to extend the time for payment of taxes for the preceding taxable year.

### **Other States' Information**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* does not impose a personal income tax. For corporate income tax purposes, *Florida* conformed to the IRC as of January 1, 2018, with some exceptions, and as such, has conformed to the TCJA amendments.

*Illinois* and *New York* have rolling conformity to the IRC, and as such, have conformed to the amendments made by the TCJA for both individual and corporate income tax purposes.

*Massachusetts* and *Minnesota* have not conformed to the amendments made by the TCJA for both individual and corporate income tax purposes.

*Michigan* and *New York* have conformed to the IRC as of January 1, 2018, with some exceptions, and as such, have conformed to the TCJA amendments for both personal and corporate income tax purposes.

### **Fiscal Impact**

The conformity provisions would not significantly impact the department's costs.

### **Policy Concerns**

By continuing the state's conformity to the federal law, many of these provisions would simplify the preparation of California tax returns for those years to which the provisions apply.

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