

Senate Bill No. 657

CHAPTER 34

An act to amend Sections 17024.5, 17039, 17052.12, 17062, 17063, 17085, 17140, 17140.3, 17144, 17275.5, 17501, 17551, 17560, 17570, 17731.5, 17751, 18038.5, 19136, 19141, 19365, 19521, 23038.5, 23456, 23457, 23609, 23701s, 23705, 23711, 23712, 23801, 23802, 23811, 24306, 24307, 24343.7, 24357, 24357.9, 24443, 24667, 24710, and 24942 of, to add Sections 17062.3, 17132, 17132.6, 17144.5, 17205, 17552.3, 17563.5, 19136.8, 23456.5, 24661.3, and 24685.5 to, to repeal Sections 17251.5, 17270.5, 17271, and 17279.5 of, to repeal and amend Section 24949.1 of, and to repeal and add Section 24424 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

[Approved by Governor May 8, 2002. Filed with
Secretary of State May 8, 2002.]

LEGISLATIVE COUNSEL'S DIGEST

SB 657, Scott. Income and bank and corporation taxes: federal conformity.

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, various provisions of the federal Internal Revenue Code, as enacted as of a specified date, are referenced in various sections of the Revenue and Taxation Code. Those laws provide that for taxable years beginning on or after January 1, 1998, the specified date of those referenced Internal Revenue Code sections is January 1, 1998, unless otherwise specifically provided.

Existing law requires, for any introduced bill that proposes changes in any of those dates, that the Franchise Tax Board prepare a complete analysis of the bill that describes all changes to state law that will automatically occur by reference to federal law as of the changed date. It further requires the Franchise Tax Board to immediately update and supplement that analysis upon any amendment to the bill, and requires that analysis to be made available to the public and to be submitted to the Legislature for publication in the daily journal of each house of the Legislature.

This bill would change the specified date of those referenced Internal Revenue Code sections to January 1, 2001, for taxable years beginning on or after January 1, 2002, and thereby would make numerous substantive changes to both the Personal Income Tax Law and the Bank and Corporation Tax Law with respect to those areas of preexisting



conformity that are subject to changes under federal laws enacted after January 1, 1998, and that have not been, or are not being, excepted or modified.

This bill would make certain other changes in federal income tax laws applicable, with specified exceptions and modifications, and make specified supplemental, technical, or clarifying changes, for purposes of the Personal Income Tax Law or the Bank and Corporation Tax Law, or both, with respect to, among other things, credits that may reduce certain taxes below the tentative minimum tax, the credit for research and development expenses, adjustments in computing alternative minimum taxable income, the exclusion of extraterritorial income, annuities and certain proceeds of life insurance contracts, the Ricky Ray Hemophilia Relief Fund Act of 1998, the denial of deduction for club dues, the mark to market accounting method, the inapplicability of excise tax on premiums paid, certain amounts paid in connection with insurance contracts, specified federal acts, the installment method of accounting, qualified state tuition programs, the Federal Agriculture Improvement and Reform Act of 1996, determinations relating to deferred compensation, taxation of estates and trusts, small business stock, failure by an individual to pay estimated income tax, underpayment of estimated tax, underpayments of installments, elimination of interest on overlapping periods of tax overpayments and underpayments, mining exploration and development costs, tax-exempt interest, “S corporations,” certain publicly traded partnerships treated as corporations, the deduction for a qualified computer contribution, secured indebtedness, tax on passive investment income, securities futures contracts, and the sale or exchange of livestock. This bill would specify various dates on which specified provisions apply, make findings and declarations that certain provisions are declaratory of existing law, and specify the intent and operation in the application of provisions conforming to various federal acts.

This bill would provide that it would only become operative if this bill and AB 1122 are both chaptered.

This bill would take effect immediately as a tax levy.

The people of the State of California do enact as follows:

SECTION 1. Section 17024.5 of the Revenue and Taxation Code is amended to read:

17024.5. (a) (1) Unless otherwise specifically provided, the terms “Internal Revenue Code,” “Internal Revenue Code of 1954,” or “Internal Revenue Code of 1986,” for purposes of this part, mean Title



26 of the United States Code, including all amendments thereto as enacted on the specified date for the applicable taxable year as follows:

Taxable Year	Specified Date of Internal Revenue Code Sections
(A) For taxable years beginning on or after January 1, 1983, and on or before December 31, 1983	January 15, 1983
(B) For taxable years beginning on or after January 1, 1984, and on or before December 31, 1984	January 1, 1984
(C) For taxable years beginning on or after January 1, 1985, and on or before December 31, 1985	January 1, 1985
(D) For taxable years beginning on or after January 1, 1986, and on or before December 31, 1986	January 1, 1986
(E) For taxable years beginning on or after January 1, 1987, and on or before December 31, 1988	January 1, 1987
(F) For taxable years beginning on or after January 1, 1989, and on or before December 31, 1989	January 1, 1989
(G) For taxable years beginning on or after January 1, 1990, and on or before December 31, 1990	January 1, 1990
(H) For taxable years beginning on or after January 1, 1991, and on or before December 31, 1991	January 1, 1991
(I) For taxable years beginning on or after January 1, 1992, and on or before December 31, 1992	January 1, 1992
(J) For taxable years beginning on or after January 1, 1993, and on or before December 31, 1996	January 1, 1993
(K) For taxable years beginning on or after January 1, 1997, and on or before December 31, 1997	January 1, 1997
(L) For taxable years beginning on or after January 1, 1998, and on or before December 31, 2001	January 1, 1998
(M) For taxable years beginning on or after January 1, 2002	January 1, 2001

(2) Unless otherwise specifically provided, for federal laws enacted on or after January 1, 1987, and on or before the specified date for the taxable year, uncodified provisions that relate to provisions of the Internal Revenue Code that are incorporated for purposes of this part shall be applicable to the same taxable years as the incorporated provisions.

(3) Subtitle G (Tax Technical Corrections) and Part I of Subtitle H (Repeal of Expired or Obsolete Provisions) of the Revenue Reconciliation Act of 1990 (Public Law 101-508) modified numerous provisions of the Internal Revenue Code and provisions of prior federal



acts, some of which are incorporated by reference into this part. Unless otherwise provided, the provisions described in the preceding sentence, to the extent that they modify provisions that are incorporated into this part, are declaratory of existing law and shall be applied in the same manner and for the same periods as specified in the Revenue Reconciliation Act of 1990.

(b) Unless otherwise specifically provided, when applying any provision of the Internal Revenue Code for purposes of this part, a reference to any of the following shall not be applicable for purposes of this part:

(1) Except as provided in Chapter 4.5 (commencing with Section 23800) of Part 11 of Division 2, an electing small business corporation, as defined in Section 1361(b) of the Internal Revenue Code.

(2) Domestic international sales corporations (DISC), as defined in Section 992(a) of the Internal Revenue Code.

(3) A personal holding company, as defined in Section 542 of the Internal Revenue Code.

(4) A foreign personal holding company, as defined in Section 552 of the Internal Revenue Code.

(5) A foreign investment company, as defined in Section 1246(b) of the Internal Revenue Code.

(6) A foreign trust, as defined in Section 679 of the Internal Revenue Code.

(7) Foreign income taxes and foreign income tax credits.

(8) Section 911 of the Internal Revenue Code, relating to United States citizens living abroad.

(9) A foreign corporation, except that Section 367 of the Internal Revenue Code shall be applicable.

(10) Federal tax credits and carryovers of federal tax credits.

(11) Nonresident aliens.

(12) Deduction for personal exemptions, as provided in Section 151 of the Internal Revenue Code.

(13) The tax on generation-skipping transfers imposed by Section 2601 of the Internal Revenue Code.

(14) The tax, relating to estates, imposed by Section 2001 or 2101 of the Internal Revenue Code.

(c) (1) The provisions contained in Sections 41 to 44, inclusive, and 172 of the Tax Reform Act of 1984 (Public Law 98-369), relating to treatment of debt instruments, shall not be applicable for taxable years beginning before January 1, 1987.

(2) The provisions contained in Public Law 99-121, relating to the treatment of debt instruments, shall not be applicable for taxable years beginning before January 1, 1987.



(3) For each taxable year beginning on or after January 1, 1987, the provisions referred to by paragraphs (1) and (2) shall be applicable for purposes of this part in the same manner and with respect to the same obligations as the federal provisions, except as otherwise provided in this part.

(d) When applying the Internal Revenue Code for purposes of this part, regulations promulgated in final form or issued as temporary regulations by “the secretary” shall be applicable as regulations under this part to the extent that they do not conflict with this part or with regulations issued by the Franchise Tax Board.

(e) Whenever this part allows a taxpayer to make an election, the following rules shall apply:

(1) A proper election filed with the Internal Revenue Service in accordance with the Internal Revenue Code or regulations issued by “the secretary” shall be deemed to be a proper election for purposes of this part, unless otherwise provided in this part or in regulations issued by the Franchise Tax Board.

(2) A copy of that election shall be furnished to the Franchise Tax Board upon request.

(3) To obtain treatment other than that elected for federal purposes, a separate election shall be filed at the time and in the manner required by the Franchise Tax Board.

(f) Whenever this part allows or requires a taxpayer to file an application or seek consent, the rules set forth in subdivision (e) shall be applicable with respect to that application or consent.

(g) When applying the Internal Revenue Code for purposes of determining the statute of limitations under this part, any reference to a period of three years shall be modified to read four years for purposes of this part.

(h) When applying, for purposes of this part, any section of the Internal Revenue Code or any applicable regulation thereunder, all of the following shall apply:

(1) References to “adjusted gross income” shall mean the amount computed in accordance with Section 17072, except as provided in paragraph (2).

(2) References to “adjusted gross income” for purposes of computing limitations based upon adjusted gross income, shall mean the amount required to be shown as adjusted gross income on the federal tax return for the same taxable year.

(3) Any reference to “subtitle” or “chapter” shall mean this part.

(4) The provisions of Section 7806 of the Internal Revenue Code, relating to construction of title, shall apply.



(5) Any provision of the Internal Revenue Code that becomes operative on or after the specified date for that taxable year shall become operative on the same date for purposes of this part.

(6) Any provision of the Internal Revenue Code that becomes inoperative on or after the specified date for that taxable year shall become inoperative on the same date for purposes of this part.

(7) Due account shall be made for differences in federal and state terminology, effective dates, substitution of “Franchise Tax Board” for “secretary” when appropriate, and other obvious differences.

(i) Any reference to a specific provision of the Internal Revenue Code shall include modifications of that provision, if any, in this part.

SEC. 2. Section 17039 of the Revenue and Taxation Code is amended to read:

17039. (a) Notwithstanding any provision in this part to the contrary, for the purposes of computing tax credits, the term “net tax” means the tax imposed under either Section 17041 or 17048 plus the tax imposed under Section 17504 (relating to lump-sum distributions) less the credits allowed by Section 17054 (relating to personal exemption credits) and any amount imposed under paragraph (1) of subdivision (d) and paragraph (1) of subdivision (e) of Section 17560. Notwithstanding the preceding sentence, the “net tax” shall not be less than the tax imposed under Section 17504 (relating to the separate tax on lump-sum distributions), if any. Credits shall be allowed against “net tax” in the following order:

(1) Credits that do not contain carryover or refundable provisions, except those described in paragraphs (4) and (5).

(2) Credits that contain carryover provisions but do not contain refundable provisions, except for those that are allowed to reduce “net tax” below the tentative minimum tax, as defined by Section 17062.

(3) Credits that contain both carryover and refundable provisions.

(4) The minimum tax credit allowed by Section 17063 (relating to the alternative minimum tax).

(5) Credits that are allowed to reduce “net tax” below the tentative minimum tax, as defined by Section 17062.

(6) Credits for taxes paid to other states allowed by Chapter 12 (commencing with Section 18001).

(7) Credits that contain refundable provisions but do not contain carryover provisions.

The order within each paragraph shall be determined by the Franchise Tax Board.

(b) Notwithstanding the provisions of Sections 17061 (relating to refunds pursuant to the Unemployment Insurance Code) and 19002



(relating to tax withholding), the credits provided in those sections shall be allowed in the order provided in paragraph (6) of subdivision (a).

(c) (1) Notwithstanding any other provision of this part, no tax credit shall reduce the tax imposed under Section 17041 or 17048 plus the tax imposed under Section 17504 (relating to the separate tax on lump-sum distributions) below the tentative minimum tax, as defined by Section 17062, except the following credits:

(A) The credit allowed by Section 17052.2 (relating to teacher retention tax credit).

(B) The credit allowed by former Section 17052.4 (relating to solar energy).

(C) The credit allowed by former Section 17052.5 (relating to solar energy, repealed on January 1, 1987).

(D) The credit allowed by former Section 17052.5 (relating to solar energy, repealed on December 1, 1994).

(E) The credit allowed by Section 17052.12 (relating to research expenses).

(F) The credit allowed by former Section 17052.13 (relating to sales and use tax credit).

(G) The credit allowed by former Section 17052.15 (relating to Los Angeles Revitalization Zone sales tax credit).

(H) The credit allowed by Section 17052.25 (relating to the adoption costs credit).

(I) The credit allowed by Section 17053.5 (relating to the renter's credit).

(J) The credit allowed by former Section 17053.8 (relating to enterprise zone hiring credit).

(K) The credit allowed by former Section 17053.10 (relating to Los Angeles Revitalization Zone hiring credit).

(L) The credit allowed by former Section 17053.11 (relating to program area hiring credit).

(M) For each taxable year beginning on or after January 1, 1994, the credit allowed by former Section 17053.17 (relating to Los Angeles Revitalization Zone hiring credit).

(N) The credit allowed by Section 17053.33 (relating to targeted tax area sales or use tax credit).

(O) The credit allowed by Section 17053.34 (relating to targeted tax area hiring credit).

(P) The credit allowed by Section 17053.49 (relating to qualified property).

(Q) The credit allowed by Section 17053.70 (relating to enterprise zone sales or use tax credit).



(R) The credit allowed by Section 17053.74 (relating to enterprise zone hiring credit).

(S) The credit allowed by Section 17054 (relating to credits for personal exemption).

(T) The credit allowed by Section 17054.5 (relating to the credits for a qualified joint custody head of household and a qualified taxpayer with a dependent parent).

(U) The credit allowed by Section 17054.7 (relating to the credit for a senior head of household).

(V) The credit allowed by former Section 17057 (relating to clinical testing expenses).

(W) The credit allowed by Section 17058 (relating to low-income housing).

(X) The credit allowed by Section 17061 (relating to refunds pursuant to the Unemployment Insurance Code).

(Y) Credits for taxes paid to other states allowed by Chapter 12 (commencing with Section 18001).

(Z) The credit allowed by Section 19002 (relating to tax withholding).

(2) Any credit that is partially or totally denied under paragraph (1) shall be allowed to be carried over and applied to the net tax in succeeding taxable years, if the provisions relating to that credit include a provision to allow a carryover when that credit exceeds the net tax.

(d) Unless otherwise provided, any remaining carryover of a credit allowed by a section that has been repealed or made inoperative shall continue to be allowed to be carried over under the provisions of that section as it read immediately prior to being repealed or becoming inoperative.

(e) (1) Unless otherwise provided, if two or more taxpayers (other than husband and wife) share in costs that would be eligible for a tax credit allowed under this part, each taxpayer shall be eligible to receive the tax credit in proportion to his or her respective share of the costs paid or incurred.

(2) In the case of a partnership, the credit shall be allocated among the partners pursuant to a written partnership agreement in accordance with Section 704 of the Internal Revenue Code, relating to partner's distributive share.

(3) In the case of a husband and wife who file separate returns, the credit may be taken by either or equally divided between them.

(f) Unless otherwise provided, in the case of a partnership, any credit allowed by this part shall be computed at the partnership level, and any limitation on the expenses qualifying for the credit or limitation upon the



amount of the credit shall be applied to the partnership and to each partner.

(g) (1) With respect to any taxpayer that directly or indirectly owns an interest in a business entity that is disregarded for tax purposes pursuant to Section 23038 and any regulations thereunder, the amount of any credit or credit carryforward allowable for any taxable year attributable to the disregarded business entity shall be limited in accordance with paragraphs (2) and (3).

(2) The amount of any credit otherwise allowed under this part, including any credit carryover from prior years, that may be applied to reduce the taxpayer's "net tax," as defined in subdivision (a), for the taxable year shall be limited to an amount equal to the excess of the taxpayer's regular tax (as defined in Section 17062), determined by including income attributable to the disregarded business entity that generated the credit or credit carryover, over the taxpayer's regular tax (as defined in Section 17062), determined by excluding the income attributable to that disregarded business entity. No credit shall be allowed if the taxpayer's regular tax (as defined in Section 17062), determined by including the income attributable to the disregarded business entity, is less than the taxpayer's regular tax (as defined in Section 17062), determined by excluding the income attributable to the disregarded business entity.

(3) If the amount of a credit allowed pursuant to the section establishing the credit exceeds the amount allowable under this subdivision in any taxable year, the excess amount may be carried over to subsequent taxable years pursuant to subdivisions (c) and (d).

(h) (1) Unless otherwise specifically provided, in the case of a taxpayer that is a partner or shareholder of an eligible passthrough entity described in paragraph (2), any credit passed through to the taxpayer in the taxpayer's first taxable year beginning on or after the date the credit is no longer operative may be claimed by the taxpayer in that taxable year, notwithstanding the repeal of the statute authorizing the credit prior to the close of that taxable year.

(2) For purposes of this subdivision, "eligible passthrough entity" means any partnership or S corporation that files its return on a fiscal year basis pursuant to Section 18566, and that is entitled to a credit pursuant to this part for the taxable year that begins during the last year the credit is operative.

(3) This subdivision shall apply to credits that become inoperative on or after the operative date of the act adding this subdivision.

SEC. 3. Section 17052.12 of the Revenue and Taxation Code is amended to read:



17052.12. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the “net tax” (as defined by Section 17039) for the taxable year an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each taxable year beginning before January 1, 1997, the reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “8 percent.”

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, the reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “11 percent.”

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, the reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “12 percent.”

(3) For each taxable year beginning on or after January 1, 2000, the reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “15 percent.”

(c) Section 41(a)(2) of the Internal Revenue Code, relating to basic research payments, shall not apply.

(d) “Qualified research” shall include only research conducted in California.

(e) In the case where the credit allowed under this section exceeds the “net tax,” the excess may be carried over to reduce the “net tax” in the following year, and succeeding years if necessary, until the credit has been exhausted.

(f) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of “qualified research expense” any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) For each taxable year beginning on or after January 1, 1998, the reference to “Section 501(a)” in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read “this part or Part 11 (commencing with Section 23001).”

(g) (1) For each taxable year beginning on or after January 1, 2000:

(A) The reference to “2.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “one and forty-nine hundredths of one percent.”

(B) The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read “one and ninety-eight hundredths of one percent.”



(C) The reference to “3.75 percent” in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read “two and forty-eight hundredths of one percent.”

(2) Section 41(c)(4)(B) shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code may be made for any taxable year of the taxpayer beginning on or after January 1, 1998. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

(3) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(h) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(i) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (e); except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

SEC. 4. Section 17062 of the Revenue and Taxation Code is amended to read:

17062. (a) In addition to the other taxes imposed by this part, there is hereby imposed for each taxable year, a tax equal to the excess, if any, of—

(1) The tentative minimum tax for the taxable year, over

(2) The regular tax for the taxable year.

(b) For purposes of this chapter, each of the following shall apply:

(1) The tentative minimum tax shall be computed in accordance with Sections 55 to 59, inclusive, of the Internal Revenue Code, except as otherwise provided in this part.

(2) The regular tax shall be the amount of tax imposed by Section 17041 or 17048, before reduction for any credits against the tax, less any amount imposed under paragraph (1) of subdivision (d) and paragraph (1) of subdivision (e) of Section 17560.

(3) (A) The provisions of Section 55(b)(1) of the Internal Revenue Code shall be modified to provide that the tentative minimum tax for the



taxable year shall be equal to the following percent of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount, before reduction for any credits against the tax:

(i) For any taxable year beginning on or after January 1, 1991, and before January 1, 1996, 8.5 percent.

(ii) For any taxable year beginning on or after January 1, 1996, 7 percent.

(B) In the case of a nonresident or part-year resident, the tentative minimum tax shall be computed by multiplying the alternative minimum taxable income of the nonresident or part-year resident, as defined in subparagraph (C), by a rate (expressed as a percentage) equal to the tax computed under subdivision (b) on the alternative minimum taxable income of the nonresident or part-year resident as if the nonresident or part-year resident were a resident of this state for the taxable year and as if the nonresident or part-year resident were a resident of this state for all prior taxable years for any carryover items, deferred income, suspended losses, or suspended deductions, divided by the amount of that income.

(C) For purposes of this section, the term “alternative minimum taxable income of a nonresident or part-year resident” includes each of the following:

(i) For any period during which the taxpayer was a resident of this state (as defined by Section 17014), all items of alternative minimum taxable income (as modified for purposes of this chapter), regardless of source.

(ii) For any period during which the taxpayer was not a resident of this state, alternative minimum taxable income (as modified for purposes of this chapter) which were derived from sources within this state, determined in accordance with Article 9 of Chapter 3 (commencing with Section 17301) and Chapter 11 (commencing with Section 17951).

(iii) For purposes of computing “alternative minimum taxable income of a nonresident or part-year resident,” any carryover items, deferred income, suspended losses, or suspended deductions shall only be allowable to the extent that the carryover item, suspended loss, or suspended deduction was derived from sources within this state.

(4) The provisions of Section 55(b)(2) of the Internal Revenue Code, relating to alternative minimum taxable income, shall be modified to provide that alternative minimum taxable income shall not include the income, adjustments, and items of tax preference attributable to any trade or business of a qualified taxpayer.

(A) For purposes of this paragraph, “qualified taxpayer” means a taxpayer who meets both of the following:

(i) Is the owner of, or has an ownership interest in, a trade or business.



(ii) Has aggregate gross receipts, less returns and allowances, of less than one million dollars (\$1,000,000) during the taxable year from all trades or businesses of which the taxpayer is the owner or has an ownership interest, in the amount of that taxpayer's proportionate interest in each trade or business.

(B) For purposes of this paragraph, "aggregate gross receipts, less returns and allowances" means the sum of the gross receipts of the trades or businesses that the taxpayer owns and the proportionate interest of the gross receipts of the trades or businesses that the taxpayer owns and of passthrough entities in which the taxpayer holds an interest.

(C) For purposes of this paragraph, "gross receipts, less returns and allowances" means the sum of the gross receipts from the production of business income, as defined in subdivision (a) of Section 25120, and the gross receipts from the production of nonbusiness income, as defined in subdivision (d) of Section 25120.

(D) For purposes of this paragraph, "proportionate interest" means:

(i) In the case of a passthrough entity that reports a profit for the taxable year, the taxpayer's profit interest in the entity at the end of the taxpayer's taxable year.

(ii) In the case of a passthrough entity that reports a loss for the taxable year, the taxpayer's loss interest in the entity at the end of the taxpayer's taxable year.

(iii) In the case of a passthrough entity that is sold or liquidates during the taxable year, the taxpayer's capital account interest in the entity at the time of the sale or liquidation.

(E) (i) For purposes of this paragraph, "proportionate interest" includes an interest in a passthrough entity.

(ii) For purposes of this paragraph, "passthrough entity" means any of the following:

(I) A partnership, as defined by Section 17008.

(II) An S corporation, as provided in Chapter 4.5 (commencing with Section 23800) of Part 11.

(III) A regulated investment company, as provided in Section 24871.

(IV) A real estate investment trust, as provided in Section 24872.

(V) A real estate mortgage investment conduit, as provided in Section 24874.

(5) For taxable years beginning on or after January 1, 1998, Section 55(d)(1) of the Internal Revenue Code, relating to exemption amount for taxpayers other than corporations is modified, for purposes of this part, to provide the following exemption amounts in lieu of those contained therein:

(A) Fifty-seven thousand two hundred sixty dollars (\$57,260) in the case of either of the following:



- (i) A joint return.
 - (ii) A surviving spouse.
- (B) Forty-two thousand nine hundred forty-five dollars (\$42,945) in the case of an individual who is both of the following:
- (i) Not a married individual.
 - (ii) Not a surviving spouse.
- (C) Twenty-eight thousand six hundred thirty dollars (\$28,630) in the case of either of the following:
- (i) A married individual who files a separate return.
 - (ii) An estate or trust.
- (6) For taxable years beginning on or after January 1, 1998, Section 55(d)(3) of the Internal Revenue Code, relating to the phaseout of exemption amount for taxpayers other than corporations is modified, for purposes of this part, to provide the following phaseout of exemption amounts in lieu of those contained therein:
- (A) Two hundred fourteen thousand seven hundred twenty-five dollars (\$214,725) in the case of a taxpayer described in subparagraph (A) of paragraph (5).
- (B) One hundred sixty-one thousand forty-four dollars (\$161,044) in the case of a taxpayer described in subparagraph (B) of paragraph (5).
- (C) One hundred seven thousand three hundred sixty-two dollars (\$107,362) in the case of a taxpayer described in subparagraph (C) of paragraph (5).
- (7) For each taxable year beginning on or after January 1, 1999, the Franchise Tax Board shall recompute the exemption amounts prescribed in paragraph (5) and the phaseout of exemption amounts prescribed in paragraph (6). Those computations shall be made as follows:
- (A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.
- (B) The Franchise Tax Board shall do both of the following:
- (i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and dividing the result by 100.
 - (ii) Multiply the preceding taxable year exemption amounts and the phaseout of exemption amounts by the inflation adjustment factor determined in clause (i) and round off the resulting products to the nearest one dollar (\$1).
- (c) (1) (A) Section 56(a)(6) of the Internal Revenue Code as in effect on January 1, 1997, relating to installment sales of certain property, shall not apply to payments received in taxable years beginning



on or after January 1, 1997, with respect to dispositions occurring in taxable years beginning after December 31, 1987.

(B) This paragraph shall not apply to taxable years beginning on or after January 1, 1998.

(2) Section 56(b)(1)(E) of the Internal Revenue Code, relating to standard deduction and deduction for personal exemptions not allowed, is modified, for purposes of this part, to deny the standard deduction allowed by Section 17073.5.

(3) Section 56(b)(3) of the Internal Revenue Code, relating to treatment of incentive stock options, shall be modified to additionally provide the following:

(A) Section 421 of the Internal Revenue Code shall not apply to the transfer of stock acquired pursuant to the exercise of a California qualified stock option under Section 17502.

(B) Section 422(c)(2) of the Internal Revenue Code shall apply in any case where the disposition and inclusion of a California qualified stock option for purposes of this chapter are within the same taxable year and that section shall not apply in any other case.

(C) The adjusted basis of any stock acquired by the exercise of a California qualified stock option shall be determined on the basis of the treatment prescribed by this paragraph.

(d) The provisions of Section 57(a)(5) of the Internal Revenue Code, relating to tax-exempt interest shall not apply.

(e) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference an amount equal to one-half of the amount excluded from gross income for the taxable year under Section 18152.5.

(f) The provisions of Section 59(a) of the Internal Revenue Code, relating to the alternative minimum tax foreign tax credit, shall not apply.

SEC. 5. Section 17062.3 is added to Revenue and Taxation Code, to read:

17062.3. The amendments made to Section 56 of the Internal Revenue Code, relating to adjustments in computing alternative minimum taxable income by Section 4(1) of Public Law 106-519, relating to the exclusion under Section 114 of the Internal Revenue Code, shall not apply.

SEC. 6. Section 17063 of the Revenue and Taxation Code is amended to read:

17063. (a) There shall be allowed as a credit against the net tax (as defined by Section 17039) for any taxable year an amount equal to the minimum tax credit for that taxable year.



(b) For purposes of subdivision (a), the minimum tax credit shall be determined in accordance with Section 53 of the Internal Revenue Code, except as otherwise provided in this part.

(c) For purposes of this chapter, the amount determined under Section 53(c)(1) of the Internal Revenue Code shall be the regular tax as defined by paragraph (2) of subdivision (b) of Section 17062, reduced by the sum of the credits allowable under this part, other than:

(1) The credits described in paragraph (7) of subdivision (a) of Section 17039.

(2) Any credit that reduces the tax below the tentative minimum tax, as defined by Section 17062.

(d) Section 53(d)(1)(B)(ii)(II) of the Internal Revenue Code, relating to credit not allowed for exclusion preferences, is modified to include subdivision (e) of Section 17062, as a specified item.

SEC. 7. Section 17085 of the Revenue and Taxation Code is amended to read:

17085. Section 72 of the Internal Revenue Code, as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), relating to annuities and certain proceeds of life insurance contracts, is modified as follows:

(a) The amendments and transitional rules made by Public Law 99-514 shall be applicable to this part for the same transactions and the same years as they are applicable for federal income tax purposes, except that the repeal of Section 72(d) of the Internal Revenue Code, relating to repeal of special rule for employees' annuities, shall apply only to the following:

(1) Any individual whose annuity starting date is after December 31, 1986.

(2) At the election of the taxpayer, any individual whose annuity starting date is after July 1, 1986, and before January 1, 1987.

(b) The amount of a distribution from an individual retirement account or annuity or employees' trust or employee annuity that is includable in gross income for federal income tax purposes shall be reduced for purposes of this part by the lesser of either of the following:

(1) An amount equal to the amount includable in federal gross income for the taxable year.

(2) An amount equal to the basis in the account or annuity allowed by Section 17507 (relating to individual retirement accounts and simplified employee pensions) or the increased basis allowed by Sections 17504 and 17506 (relating to plans of self-employed individuals), the increased basis allowed by Section 17501, or the increased basis allowed by Section 17551 that is remaining after adjustment for reductions in gross income under this provision in prior taxable years.



(c) (1) Except as provided in paragraph (2), the amount of the penalty imposed under this part shall be computed in accordance with Sections 72(m), (q), (t), and (v) of the Internal Revenue Code using a rate of 2¹/₂ percent, in lieu of the rate provided in those sections.

(2) In the case where Section 72(t)(6) of the Internal Revenue Code, relating to special rules for simple retirement accounts, applies, the rate in paragraph (1) shall be 6 percent in lieu of the 2¹/₂ percent rate specified therein.

(d) Section 72(f)(2) of the Internal Revenue Code, relating to special rules for computing employees' contributions, shall be applicable without applying the exceptions which immediately follow that paragraph.

SEC. 8. Section 17132 is added to the Revenue and Taxation Code, to read:

17132. Section 114 of the Internal Revenue Code, relating to extraterritorial income, shall not apply.

SEC. 9. Section 17132.6 is added to the Revenue and Taxation Code, to read:

17132.6. A payment under Section 103(c)(10) of the Ricky Ray Hemophilia Relief Fund Act of 1998 (Public Law 105-369) to an individual shall be treated for purposes of this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001) as damages described in Section 104(a)(2) of the Internal Revenue Code.

SEC. 10. Section 17140 of the Revenue and Taxation Code is amended to read:

17140. (a) For purposes of this section, the following terms have the following meanings as provided in the Golden State Scholarshare Trust Act (Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code):

(1) "Beneficiary" has the meaning set forth in subdivision (c) of Section 69980 of the Education Code.

(2) "Benefit" has the meaning set forth in subdivision (d) of Section 69980 of the Education Code.

(3) "Participant" has the meaning set forth in subdivision (h) of Section 69980 of the Education Code.

(4) "Participation agreement" has the meaning set forth in subdivision (i) of Section 69980 of the Education Code.

(5) "Scholarshare trust" has the meaning set forth in subdivision (f) of Section 69980 of the Education Code.

(b) Except as otherwise provided in subdivision (c), gross income of a beneficiary or a participant does not include any of the following:



(1) Any distribution or earnings under a Scholarshare trust participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(2) Any contribution to the Scholarshare trust on behalf of a beneficiary shall not be includable as gross income of that beneficiary.

(c) (1) Any distribution under a Scholarshare trust participation agreement shall be includable in the gross income of the distributee in the manner as provided under Section 72 of the Internal Revenue Code, as modified by Section 17085, to the extent not excluded from gross income under this part. For purposes of applying Section 72 of the Internal Revenue Code, the following apply:

(A) All Scholarshare trust accounts of which an individual is a beneficiary shall be treated as one account, except as otherwise provided.

(B) All distributions during a taxable year shall be treated as one distribution.

(C) The value of the participation agreement, income on the participation agreement, and investment in the participation agreement shall be computed as of the close of the calendar year in which the taxable year begins.

(2) A contribution by a for-profit or nonprofit entity, or by a state or local government agency, for the benefit of an owner or employee of that entity or a beneficiary whom the owner or employee has the power to designate, including the owner or employee's minor children, shall be included in the gross income of that owner or employee in the year the contribution is made.

(3) For purposes of this subdivision, "distribution" includes any benefit furnished to a beneficiary under a participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(4) (A) Paragraph (1) shall not apply to that portion of any distribution that, within 60 days of distribution, is transferred to the credit of another beneficiary under the Scholarshare trust who is a "member of the family," as that term is used in Section 529(e)(2) of the Internal Revenue Code, as amended by Section 211 of the Taxpayer Relief Act of 1997 (Public Law 105-34), of the former beneficiary of that Scholarshare trust.

(B) Any change in the beneficiary of an interest in the Scholarshare trust shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a "member of the family," as that term is used in Section 529(e)(2) of the Internal Revenue Code, as amended by Section 211 of the Taxpayer Relief Act of 1997 (Public Law 105-34), of the former beneficiary of that Scholarshare trust.



(d) For taxable years beginning on or after January 1, 2002, Sections 529(c) and 529(e) of the Internal Revenue Code, as amended by Section 402 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 417 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), shall apply in lieu of subdivisions (b) and (c) of this section.

SEC. 11. Section 17140.3 of the Revenue and Taxation Code is amended to read:

17140.3. Section 529 of the Internal Revenue Code, as amended by Section 402 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 417 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147) relating to qualified state tuition programs, shall apply, except as otherwise provided.

(a) Section 529 (a) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase “under this part and Part 11 (commencing with Section 23001)” in lieu of the phrase “under this subtitle.”

(2) By substituting “Article 2 (commencing with Section 23731)” in lieu of “Section 511.”

(b) A copy of the report required to be filed with the Secretary of the Treasury under Section 529(d) of the Internal Revenue Code shall be filed with the Franchise Tax Board at the same time and in the same manner as specified in that section.

SEC. 12. Section 17144 of the Revenue and Taxation Code is amended to read:

17144. (a) Section 108(b)(2)(B) of the Internal Revenue Code, relating to general business credit, is modified by substituting “this part” in lieu of “Section 38 (relating to general business credit).”

(b) Section 108(b)(2)(G) of the Internal Revenue Code, relating to foreign tax credit carryovers, shall not apply.

(c) Section 108(b)(3)(B) of the Internal Revenue Code, relating to credit carryover reduction, is modified by substituting “11.1 cents” in lieu of “33¹/₃ cents” in each place in which it appears. In the case where more than one credit is allowable under this part, the credits shall be reduced on a pro rata basis.

(d) Section 108(g)(3)(B) of the Internal Revenue Code, relating to adjusted tax attributes, is modified by substituting “(\$9)” in lieu of “(\$3).”

(e) (1) If a taxpayer makes an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness,



a separate election shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5 and the federal election shall be binding for purposes of this part.

(2) If a taxpayer has not made an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, then the taxpayer shall not be allowed to make that election for purposes of this part.

(f) The amendments made to Section 108(d)(7)(A) of the Internal Revenue Code, relating to certain provisions to be applied at the corporate level, by Section 402 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), shall apply to discharges of indebtedness after December 31, 2001, in taxable years ending after that date. This subdivision shall not apply to any discharge of indebtedness made before March 1, 2002, pursuant to a plan of reorganization filed with a bankruptcy court on or before October 11, 2001.

SEC. 13. Section 17144.5 is added to the Revenue and Taxation Code, to read:

17144.5. Section 132 of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), shall apply except as otherwise provided.

SEC. 14. Section 17205 is added to the Revenue and Taxation Code, to read:

17205. Section 219 of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), relating to retirement savings, shall apply, except as otherwise provided.

SEC. 15. Section 17251.5 of the Revenue and Taxation Code is repealed.

SEC. 16. Section 17270.5 of the Revenue and Taxation Code is repealed.

SEC. 17. Section 17271 of the Revenue and Taxation Code is repealed.

SEC. 18. Section 17275.5 of the Revenue and Taxation Code is amended to read:

17275.5. (a) No deduction shall be denied under Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions, upon a showing that the requirements in Section 170(f)(8) of the Internal Revenue Code have been met with respect to that contribution for federal purposes.

(b) Section 170(f)(10)(F) of the Internal Revenue Code, relating to the excise tax on premiums paid, shall not apply.



SEC. 19. Section 17279.5 of the Revenue and Taxation Code is repealed.

SEC. 20. Section 17501 of the Revenue and Taxation Code is amended to read:

17501. (a) Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to deferred compensation, shall apply, except as otherwise provided.

(b) Notwithstanding Section 17024.5, Part I of Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to pension, profit sharing, stock bonus plans, etc., shall apply, except as otherwise provided, without regard to taxable year to the same extent as applicable for federal purposes.

(c) The maximum amount of elective deferrals (as defined in Section 402(g)(3)) for the taxable year that may be excluded from gross income under Section 403(g) of the Internal Revenue Code, as applicable for state purposes, shall not exceed the amount of elective deferrals that may be excluded from gross income under Section 402(g) of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 411 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), including additional elective deferrals under Section 414(v) of the Internal Revenue Code, as added by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 411 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147).

(d) (1) For taxable years beginning on or after January 1, 2002, the basis of any person in the plan, account, or annuity shall be increased by the amount of elective deferrals not excluded as a result of the application of subdivision (c).

(2) Any basis described in paragraph (1) shall be recovered in the manner specified in Section 17085.

(e) Notwithstanding the limitations provided in subdivision (c), any income attributable to elective deferrals in taxable years beginning on or after January 1, 2002, in conformance with Part I of Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, as applicable for federal and state purposes, shall not be includable in the gross income of the individual for whose benefit the plan or account was established until distributed pursuant to the plan or by operation of law.

SEC. 21. Section 17551 of the Revenue and Taxation Code is amended to read:

17551. (a) Subchapter E of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to accounting periods and methods of accounting, shall apply, except as otherwise provided.



(b) Section 444(c)(1) of the Internal Revenue Code, relating to effect of election, shall not apply.

(c) (1) Notwithstanding Section 17024.5, Section 457 of the Internal Revenue Code, relating to deferred compensation plans of state and local governments and tax-exempt organizations, shall apply, except as otherwise provided, without regard to taxable year to the same extent as applicable for federal purposes.

(2) The maximum deferred compensation for the taxable year that may be excluded from gross income under Section 457 of the Internal Revenue Code shall not exceed the amount of deferred compensation that may be excluded from gross income under Section 457 of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 411 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), including additional elective deferrals under Section 414(v) of the Internal Revenue Code, as added by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 411 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147).

(d) (1) For taxable years beginning on or after January 1, 2002, the basis of any person in the plan shall be increased by the amount of compensation not allowed to be excluded under subdivision (a).

(2) Any basis described in paragraph (1) shall be recovered in the manner specified in Section 17085.

(e) Notwithstanding the limitations provided in subdivision (a), any income attributable to compensation deferred in a plan in taxable years beginning on or after January 1, 2002, in conformance with Section 457 of the Internal Revenue Code, as applicable for federal and state purposes, shall not be includable in the gross income of the individual for whose benefit the plan was established until distributed pursuant to the plan or by operation of law.

SEC. 22. Section 17552.3 is added to the Revenue and Taxation Code, to read:

17552.3. (a) (1) The options under Sections 112(d)(2) and 112(d)(3) of the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. Sec. 7212(d)(2) and (3)), as in effect on October 21, 1998, shall be disregarded in determining the taxable year for which any payment under a production flexibility contract under Subtitle B of Title I of that act (as so in effect) is properly includable in gross income for purposes of this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001).

(2) In order to provide farmers with the same tax treatment for all payments in years beginning before January 1, 2002, with respect to



production flexibility contract payments as provided under federal law as modified by Public Law 105-277, this subdivision shall apply to taxable years ending after December 31, 1995.

(b) Any option to accelerate the receipt of any payment under a production flexibility contract entered into on or after January 1, 2002, that is payable under the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. Sec. 7200 et seq.) as in effect on December 17, 1999, shall be disregarded in determining the taxable year for which that payment is properly includable in gross income for purposes of this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001).

SEC. 23. Section 17560 of the Revenue and Taxation Code is amended to read:

17560. (a) The provisions of Sections 811(c)(4), 811(c)(6), and 811(c)(7) of Public Law 99-514, as modified by Section 1008(f) of Public Law 100-647, shall apply.

(b) The provisions of Section 812 of Public Law 99-514, relating to the disallowance of use of installment method for certain obligations as modified by Section 1008(g) of Public Law 100-647, shall apply to taxable years beginning on or after January 1, 1987.

(c) The repeal of Section 453C of the Internal Revenue Code by Section 10202(a) of Public Law 100-203, relating to repeal of the proportionate disallowance of the installment method, shall apply to dispositions in taxable years beginning on or after January 1, 1990.

(d) (1) In the case of any installment obligation to which Section 453(l)(2)(B) of the Internal Revenue Code applies, in lieu of the provisions of Section 453(l)(3)(A) of the Internal Revenue Code, the tax imposed under Section 17041 or 17048 for any taxable year for which payment is received on that obligation shall be increased by the amount of interest determined in the manner provided under Section 453(l)(3)(B) of the Internal Revenue Code.

(2) The provisions of Sections 10202 and 10204 of Public Law 100-203 are modified to provide for each of the following:

(A) The provisions of Section 10202 shall apply to dispositions in taxable years beginning on or after January 1, 1990.

(B) The provisions of Section 10204 shall apply to costs incurred in taxable years beginning on or after January 1, 1990.

(C) Any adjustments required by Section 481 of the Internal Revenue Code shall be included in gross income as follows:

(i) Fifty percent in the first taxable year beginning on or after January 1, 1990.

(ii) Fifty percent in the second taxable year beginning on or after January 1, 1990.



(e) (1) In the case of any installment obligation to which Section 453A of the Internal Revenue Code applies and which is outstanding as of the close of the taxable year, in lieu of the provisions of Section 453A(c)(1) of the Internal Revenue Code, the tax imposed by Section 17041 or 17048 for the taxable year shall be increased by the amount of interest determined in the manner provided under Section 453A(c)(2) of the Internal Revenue Code.

(2) The provisions of Section 453A(c)(3)(B) of the Internal Revenue Code, relating to the maximum rate used in calculating the deferred tax liability, are modified to refer to the maximum rate of tax imposed under Section 17041 in lieu of the maximum rate of tax imposed under Section 1 or 11 of the Internal Revenue Code.

(f) (1) The last sentence of Section 453A(d)(4) of the Internal Revenue Code, relating to secured indebtedness, shall not apply.

(2) This subdivision shall apply to sales or other dispositions occurring on or after January 1, 2002.

SEC. 24. Section 17563.5 is added to the Revenue and Taxation Code, to read:

17563.5. (a) The amendment made by Section 7001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) to Section 404(a)(11) of the Internal Revenue Code, regarding determinations relating to deferred compensation, shall apply to taxable years beginning on or after January 1, 2002.

(b) In the case of any taxpayer required by enactment of this section to change the method of accounting, for that taxpayer's first taxable year beginning on or after January 1, 2002, each of the following shall apply for purposes of this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001):

(1) The change shall be treated as initiated by the taxpayer.

(2) The change shall be treated as made with the consent of the Franchise Tax Board.

(3) The net amount of the adjustments required to be taken into account by the taxpayer under Chapter 6 (commencing with Section 17551) shall be taken into account ratably over the three-taxable-year period beginning with that taxpayer's first taxable year beginning on or after January 1, 2002.

SEC. 25. Section 17570 of the Revenue and Taxation Code is amended to read:

17570. (a) Section 13233(c)(2)(C) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to the effective date for changes in the mark to market accounting method for securities dealers, is modified to provide that the amount taken into account under Section 481 of the Internal Revenue Code of 1986 shall be taken into account



ratably over the five-taxable-year period beginning with the first taxable year beginning on or after January 1, 1997.

(b) In the case of any taxpayer required by the enactment of the act adding this subdivision, which act incorporated by reference the amendments made by Section 7003 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) to Section 475 of the Internal Revenue Code, for taxable years beginning on or after January 1, 2002, to change its method of accounting on its first taxable year beginning on or after January 1, 2002, then each of the following shall apply for purposes of this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001):

(1) The change shall be treated as initiated by the taxpayer.

(2) The change shall be treated as made with the consent of the Franchise Tax Board.

(3) The taxpayer shall not be required to make a change in the method of accounting until the first taxable year beginning on or after January 1, 2002.

(4) The net amount of the adjustments required to be taken into account by the taxpayer under Chapter 6 (commencing with Section 17551) shall be taken into account ratably over the three-taxable-year period beginning with that taxpayer's first taxable year beginning on or after January 1, 2002.

(c) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 475(e) of the Internal Revenue Code, relating to election of mark to market for dealers in commodities, to have Section 475 of the Internal Revenue Code apply, Section 475 of the Internal Revenue Code shall apply to that dealer in commodities for state purposes, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, and the federal election shall be binding for purposes of this part.

(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(e) of the Internal Revenue Code, relating to election of mark to market for dealers in commodities, to have Section 475 of the Internal Revenue Code apply, an election under Section 475(e) of the Internal Revenue Code shall not be allowed for state purposes, Section 475 of the Internal Revenue Code shall not apply to that dealer in commodities for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

(d) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 475(f)(1) of the Internal Revenue Code, relating to election of mark to market for traders in securities, to have Section 475 of the Internal Revenue Code apply to a trade or business, Section 475



of the Internal Revenue Code shall apply to that trader in securities for state purposes with respect to that trade or business, a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, and the federal election shall be binding for purposes of this part.

(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(f)(1) of the Internal Revenue Code, relating to election of mark to market for traders in securities, to have Section 475 of the Internal Revenue Code apply to a trade or business, an election under Section 475(f)(1) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in securities for state purposes with respect to that trade or business, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

(e) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply to a trade or business, Section 475 of the Internal Revenue Code shall apply to that trader in commodities for state purposes with respect to that trade or business, a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, and the federal election with respect to that trade or business shall be binding for purposes of this part.

(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply to a trade or business, an election under Section 475(f)(2) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in commodities for state purposes with respect to that trade or business, and a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

(f) (1) An election under Section 475(e) or (f) of the Internal Revenue Code made for federal purposes with respect to a taxable year beginning before January 1, 1998, shall be treated as having been made for state purposes with respect to the first taxable year beginning on or after January 1, 1998.

(2) Section 1001(d)(4)(B) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to the effective date for election of mark to market



by securities traders and traders and dealers in commodities, is modified to provide that the requirement for timely identification shall be treated as timely made for state purposes if that identification is treated as timely made for federal purposes, and the amount taken into account under Section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the four-taxable-year period beginning with the first taxable year beginning on or after January 1, 1998.

SEC. 26. Section 17731.5 of the Revenue and Taxation Code is amended to read:

17731.5. (a) Section 641(c)(2)(A) of the Internal Revenue Code is modified to read: “The amount of the tax imposed by subdivision (e) of Section 17041 shall be determined by using the highest rate of tax applicable to an individual under subdivision (a) of Section 17041.”

(b) Section 641(c)(2)(B) of the Internal Revenue Code is modified to read: “The credit allowed under subdivision (b) of Section 17733 shall be zero.”

SEC. 27. Section 17751 of the Revenue and Taxation Code is amended to read:

17751. Section 645 of the Internal Revenue Code, relating to certain revocable trusts treated as part of estate, is modified as follows:

(a) An election under Section 645(a) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as an election made by the executor, if any, of the estate and the trustee of the qualified revocable trust under Section 645(a) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(b) If the executor, if any, of the estate and the trustee of a qualified revocable trust fail to make an election under Section 645(a) of the Internal Revenue Code for federal purposes with respect to that qualified revocable trust, that trust shall be treated and taxed for purposes of this part as a separate trust, an election under Section 645(a) of the Internal Revenue Code for state purposes with respect to that trust shall not be allowed, and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed with respect to that trust.

SEC. 28. Section 18038.5 of the Revenue and Taxation Code is amended to read:

18038.5. (a) In the case of any sale of qualified small business stock held by a taxpayer other than a corporation for more than six months and with respect to which that taxpayer elects the application of this section, gain from that sale shall be recognized only to the extent that the amount realized on that sale exceeds:



(1) The cost of any qualified small business stock purchased by the taxpayer during the 60-day period beginning on the date of that sale, reduced by

(2) Any portion of the cost previously taken into account under this section.

This section shall not apply to any gain that is treated as ordinary income for purposes of this part.

(b) For purposes of this section:

(1) The term “qualified small business stock” has the meaning given that term by subdivision (c) of Section 18152.5.

(2) A taxpayer shall be treated as having purchased any property if, but for paragraph (3), the unadjusted basis of that property in the hands of the taxpayer would be its cost (within the meaning of Section 1012 of the Internal Revenue Code).

(3) If gain from any sale is not recognized by reason of subdivision (a), that gain shall be applied to reduce (in the order acquired) the basis for determining gain or loss of any qualified small business stock that is purchased by the taxpayer during the 60-day period described in subdivision (a).

(4) For purposes of determining whether the nonrecognition of gain under subdivision (a) applies to stock that is sold, both of the following shall apply:

(A) The taxpayer’s holding period for that stock and the stock referred to in paragraph (1) of subdivision (a) shall be determined without regard to section 1223 of the Internal Revenue Code.

(B) Only the first six months of the taxpayer’s holding period for the stock referred to in paragraph (1) of subdivision (a) shall be taken into account for purposes of applying paragraph (2) of subdivision (c) of Section 18152.5.

(5) Rules similar to the rules of subdivisions (f), (g), (h), (i), (j), and (k) of Section 18152.5 shall apply.

(c) This section shall apply to sales made after August 5, 1997.

SEC. 29. Section 19136 of the Revenue and Taxation Code is amended to read:

19136. (a) Section 6654 of the Internal Revenue Code, relating to failure by an individual to pay estimated income tax, shall apply, except as otherwise provided.

(b) Section 6654(a)(1) of the Internal Revenue Code is modified to refer to the rate determined under Section 19521 in lieu of Section 6621 of the Internal Revenue Code.

(c) (1) Section 6654(e)(1) of the Internal Revenue Code, relating to exceptions where the tax is a small amount, shall not apply.



(2) No addition to the tax shall be imposed under this section if the tax imposed under Section 17041 or 17048 for the preceding taxable year, minus the sum of any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, or the tax computed under Section 17041 or 17048 upon the estimated income for the taxable year, minus the sum of any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, is less than two hundred dollars (\$200), except in the case of a separate return filed by a married person the amount shall be less than one hundred dollars (\$100).

(d) Section 6654(f) of the Internal Revenue Code shall not apply and for purposes of this section the term “tax” means the tax imposed under Section 17041 or 17048, less any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, other than the credit provided by subdivision (a) of Section 19002.

(e) The credit for tax withheld on wages, as specified in Section 6654(g) of the Internal Revenue Code, shall be the credit allowed under subdivision (a) of Section 19002.

(f) This section shall apply to a nonresident individual.

SEC. 30. Section 19136.8 is added to the Revenue and Taxation Code, to read:

19136.8. (a) No addition to tax shall be made under Section 19136 for any period before April 15, 2003, with respect to any underpayment of an installment for the 2002 taxable year, to the extent that the underpayment was created or increased by any provision of the act adding this section.

(b) No addition to tax shall be made under Section 19142 for any period before April 15, 2003, with respect to any underpayment of an installment for the 2002 taxable year, to the extent that the underpayment was created or increased by any provision of the act adding this section.

(c) The Franchise Tax Board shall implement this section in a reasonable manner.

SEC. 31. Section 19141 of the Revenue and Taxation Code is amended to read:

19141. Upon certification by the Secretary of State pursuant to subdivision (a) of Section 2204 or subdivision (a) of Section 17563 of the Corporations Code, the Franchise Tax Board shall assess a penalty of two hundred fifty dollars (\$250). Upon certification by the Secretary of State pursuant to subdivision (a) of Section 6810 or subdivision (a) of Section 8810 of the Corporations Code, the Franchise Tax Board shall assess a penalty of fifty dollars (\$50). Any penalty assessed under this section shall be a final assessment due and payable at the time of assessment but no interest shall accrue thereon. The assessment shall be collected as other taxes, interest, and penalties are collected by the



Franchise Tax Board unless the Secretary of State decertifies the name of the corporation as provided in subdivision (e) or (f) of Section 2204, subdivision (e) of Section 6810, or subdivision (e) of Section 8810 of the Corporations Code.

SEC. 32. Section 19365 of the Revenue and Taxation Code is amended to read:

19365. (a) (1) A corporation electing to be treated as an “S corporation” for a taxable year beginning in 2002 under Chapter 4.5 (commencing with Section 23800) of Part 11 may file an application for the transfer of an overpayment with respect to payments of estimated tax for taxable years beginning in 2002 to the personal income tax accounts of its shareholders. An application under this subdivision shall not constitute a claim for credit or refund.

(2) An application under this subdivision shall be verified in the manner prescribed by Section 18621 in the case of the taxpayer, and shall be filed in the manner and form prescribed by the Franchise Tax Board. The application shall set forth all of the following:

(A) The amount the “S corporation” estimates as its tax liability under this part for the taxable year, which shall not be less than the greater of 1¹/₂ percent of its net income or the applicable minimum franchise tax.

(B) The amount and date of the estimated tax paid during the taxable year.

(C) For each shareholder affected, his or her name, social security account number, address, and percentage of ownership, and any changes in that percentage of ownership for the S corporation’s taxable year, the amount of each overpayment to be transferred, and the date the amount was paid.

(D) Any other information for purposes of carrying out this section as may be required by the Franchise Tax Board.

(b) (1) Within a period of 45 days from the date on which an application for a transfer is filed under subdivision (a), the Franchise Tax Board shall make, to the extent it deems practicable in that period, a limited examination of the application to discover omissions and errors therein, and shall determine the final amount of the transfers upon the basis of the application and the examination, except that the Franchise Tax Board may disallow, without further action, any application which it finds contains material omissions or errors which it deems cannot be corrected within the 45-day period.

(2) The Franchise Tax Board, within the 45-day period referred to in paragraph (1), may credit the amount of the overpayment against any liability on the part of the taxpayer under Part 11 (commencing with Section 23001).



(3) In the event the amount available for transfer is less than requested by the taxpayer, the overpayment amount shall be allocated among the shareholders on a pro rata basis based on their percentage of ownership stated on the application.

(4) For purposes of Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), and this part, the transferred amounts shall be treated as if they had been estimated tax payments paid by the respective shareholders on the date originally paid by the corporation.

(5) No application under subdivision (a) shall be allowed unless the amount to be transferred equals or exceeds five hundred dollars (\$500).

(6) Each S corporation which files an application for transfer of overpayments under subdivision (a) shall furnish to each person who is a shareholder at any time during the taxable year a statement showing amounts and dates of the overpayments being transferred to that person's personal income tax account.

SEC. 33. Section 19521 of the Revenue and Taxation Code is amended to read:

19521. (a) The rate established under this section (referred to in other code sections as "the adjusted annual rate") shall be determined in accordance with Section 6621 of the Internal Revenue Code, except that:

(1) The overpayment rate specified in Section 6621(a)(1) of the Internal Revenue Code shall be modified to be equal to the underpayment rate determined under Section 6621(a)(2) of the Internal Revenue Code; and

(2) The determination specified in Section 6621(b) of the Internal Revenue Code shall be modified to be determined semiannually as follows:

(A) The rate for January shall apply during the following July through December, and

(B) The rate for July shall apply during the following January through June.

(b) (1) For purposes of this part, Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), and any other provision of law referencing this method of computation, in computing the amount of any interest required to be paid by the state or by the taxpayer, or any other amount determined by reference to that amount of interest, that interest and that amount shall be compounded daily.

(2) Paragraph (1) shall not apply for purposes of computing the amount of any addition to tax under Section 19136 or 19142.



(c) Section 6621(c) of the Internal Revenue Code, relating to increase in underpayment rate for large corporate underpayments, is modified as follows:

(1) The applicable date shall be the 30th day after the earlier of either of the following:

(A) The date on which the proposed deficiency assessment is issued.

(B) The date on which the notice and demand is sent.

(2) This subdivision shall apply for purposes of determining interest for periods after December 31, 1991.

(3) Section 6621(c)(2)(B)(iii) of the Internal Revenue Code shall apply for purposes of determining interest for periods after December 31, 1998.

(d) Section 6621(d) of the Internal Revenue Code, relating to the elimination of interest on overlapping periods of tax overpayments and underpayments, shall not apply.

SEC. 34. Section 23038.5 of the Revenue and Taxation Code is amended to read:

23038.5. (a) Section 7704 of the Internal Revenue Code, relating to certain publicly traded partnerships treated as corporations, shall apply, except as otherwise provided.

(b) (1) Section 7704(a) of the Internal Revenue Code shall not apply to an electing 1987 partnership.

(2) For purposes of this subdivision, the term “electing 1987 partnership” means any publicly traded partnership if all of the following apply:

(A) The partnership is an existing partnership (as defined in Section 10211(c)(2) of the Revenue Reconciliation Act of 1987).

(B) Section 7704(a) of the Internal Revenue Code has not applied (and without regard to Section 7704(c)(1) of the Internal Revenue Code would not have applied) to that partnership for all prior taxable years beginning after December 31, 1987, and before January 1, 1998.

(C) (i) The partnership has made the election under Section 7704(g)(2)(C) of the Internal Revenue Code for federal tax purposes.

(ii) The election for federal tax purposes described in clause (i) shall be treated as a binding election and a separate election for state tax purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.

(iii) The election for federal tax purposes described in clause (i) shall be treated as a binding consent to the application of the tax imposed under paragraph (3) and a separate election for state tax purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.



(D) A partnership that, but for this subparagraph, would be treated as an electing 1987 partnership shall cease to be so treated (and the election under subparagraph (C) shall cease to be in effect) as of the first day after December 31, 1997, that the partnership is no longer treated as an electing 1987 partnership for federal tax purposes (and the election under Section 7704(g)(2)(C) of the Internal Revenue Code ceases to be in effect for federal tax purposes).

(3) (A) There is hereby imposed for each taxable year beginning on or after January 1, 1998, on the gross income of each electing 1987 partnership a tax equal to 1 percent of that partnership's gross income from all sources reportable to this state, taking into account Section 25101 and any election under Section 25110, attributable to the active conduct of trades and businesses by the partnership.

(B) The tax shall be due and payable on the date the return of the partnership is required to be filed under Section 18633 and shall be paid by the partnership. The tax shall be paid, collected, and refunded in the same manner as other taxes imposed by this part on corporations, and shall be subject to interest and applicable penalties. Section 19147 shall be applied to the partnership with respect to the tax imposed by this paragraph in the same manner as if references in that section to the taxable income were references to gross income referred to in subparagraph (A).

(C) For purposes of this paragraph, if a partnership is a partner in another partnership, the gross income referred to in subparagraph (A) shall include the partnership's distributive share of the gross income of the other partnership from all sources reportable to this state, taking into account Section 25101 and any election under Section 25110, attributable to the active conduct of trades and businesses of that other partnership. A similar rule shall apply in the case of lower-tiered partnerships.

(D) The tax imposed by this paragraph shall be treated as imposed by this part other than for purposes of determining the amount of any credit allowable under this part.

(4) The provisions of this subdivision shall apply to the taxable year for which the election described in clause (i) of subparagraph (C) of paragraph (2) is made for federal purposes and all subsequent taxable years unless revoked by the partnership for federal purposes. Any revocation made for federal purposes shall be treated as a binding revocation under this part, but, once so revoked, may not be reinstated and a separate revocation for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.



(c) The amendment made to this section by the act adding this subdivision shall apply to taxable years beginning on or after January 1, 1998.

SEC. 35. Section 23456 of the Revenue and Taxation Code is amended to read:

23456. For purposes of this part, Section 56 of the Internal Revenue Code is modified as follows:

(a) (1) Section 56(a)(2) of the Internal Revenue Code, relating to mining exploration and development costs, shall apply only to expenses incurred during taxable years beginning on or after January 1, 1988.

(2) Section 56(a)(5) of the Internal Revenue Code, relating to pollution control facilities, shall apply only to amounts allowable as a deduction under Section 24372.3.

(3) (A) Section 56(a)(6) of the Internal Revenue Code, as in effect on January 1, 1997, relating to installment sales of certain property, shall not apply to payments received in taxable years beginning on or after January 1, 1997, with respect to dispositions occurring in taxable years beginning after December 31, 1987.

(B) This paragraph shall not apply to any taxable year beginning on or after January 1, 1998.

(b) For purposes of applying Section 56(d) of the Internal Revenue Code, all references to “December 31, 1986,” are modified to read “December 31, 1987,” and all references to “January 1, 1987,” are modified to read “January 1, 1988.”

(c) Section 56(d)(1) of the Internal Revenue Code, relating to the alternative tax net operating loss deduction, is modified to include the provisions of Section 25108.

(d) For each taxable year beginning on or after January 1, 1988, and before January 1, 1990, Section 56(f)(2)(E) of the Internal Revenue Code, as it read during that period, is modified to refer to both of the following:

(1) Cooperatives under Section 24404 in lieu of the deduction allowed under Section 1382(b) of the Internal Revenue Code.

(2) Credit unions under Section 24405 as though the deduction allowed under Section 1382(b) of the Internal Revenue Code applied to credit unions.

(e) Section 56(g) of the Internal Revenue Code, relating to adjustments based on adjusted current earnings, is modified to provide that for corporations whose income is determined under Chapter 17 (commencing with Section 25101), adjusted current earnings shall be allocated and apportioned in the same manner as net income is allocated and apportioned for purposes of the regular tax. In addition, each of the following shall apply:



(1) Sections 56(g)(1)(A) and 56(g)(3) of the Internal Revenue Code are modified to provide that the term “adjusted current earnings” means the sum of the adjusted current earnings of that corporation apportionable to this state and the adjusted current earnings allocable to this state.

(2) Section 56(g)(1)(B) of the Internal Revenue Code is modified to provide that the term “alternative minimum taxable income” means the sum of the alternative minimum taxable income of that corporation apportionable to this state and the alternative minimum taxable income allocable to this state.

(f) Section 56(g)(4)(A) of the Internal Revenue Code is modified to provide the following:

(1) In the case of any property placed in service on or after January 1, 1981, and prior to January 1, 1987, other than residential rental property for which an election was made under former Section 24349.5, the amount allowable as depreciation or amortization with respect to that property shall be the same amount that would have been allowable for the taxable year had the taxpayer depreciated the property under the straight line method for each taxable year of the useful life (determined without regard to Section 24354.2) for which the taxpayer has held the property.

(2) In the case of any property placed in service on or after January 1, 1987, and prior to January 1, 1990, other than residential rental property for which an election was made under former Section 24349.5, the amount allowable as depreciation or amortization with respect to that property shall be determined by each of the following:

(A) Taking into account the adjusted basis of that property (as determined for purposes of computing alternative minimum taxable income) as of the close of the last taxable year beginning before January 1, 1990.

(B) Using the straight line method over the remainder of the recovery period applicable to that property under the alternative system of Section 168(g) of the Internal Revenue Code.

(3) The amendments made to paragraph (2) by the act adding this paragraph shall apply to taxable years beginning on or after January 1, 1990.

(4) The last sentence of Section 56(g)(4)(A)(i) of the Internal Revenue Code, shall not apply to taxable years beginning before January 1, 1998.

(g) (1) Section 56(g)(4)(C) of the Internal Revenue Code, relating to disallowance of items not deductible in computing earnings and profits, shall be modified as follows:



(A) (i) A deduction shall be allowed for amounts allowable as a deduction for purposes of the regular tax under Sections 24402, 24410, 24411, and 25106.

(ii) For each taxable year beginning on or after January 1, 1990, a deduction shall be allowed for amounts allowable as a deduction to a credit union for purposes of the regular tax under Section 24405.

(B) Section 56(g)(4)(C)(ii) of the Internal Revenue Code, relating to special rule for 100-percent dividends, shall not be applicable.

(C) Section 56(g)(4)(C)(iii) of the Internal Revenue Code, relating to special rule for dividends from Section 936 companies, shall not be applicable.

(D) Section 56(g)(4)(C)(iv) of the Internal Revenue Code, relating to special rule for certain dividends received by certain cooperatives, shall not be applicable.

(2) Section 56(g)(4)(D)(ii) of the Internal Revenue Code is modified to specify that Sections 24364 and 24407 shall not apply to expenditures paid or incurred in taxable years beginning on or after January 1, 1990.

(3) With respect to corporations that are not subject to the tax imposed under Chapter 2 (commencing with Section 23101), the amount of interest income included in the adjusted current earnings shall not exceed the amount of interest income included for purposes of the regular tax.

(4) Appropriate adjustments shall be made to limit deductions from adjusted current earnings for interest expense in accordance with the provisions of Sections 24344 and 24425.

SEC. 36. Section 23456.5 is added to the Revenue and Taxation Code, to read:

23456.5. The amendments to Section 56 of the Internal Revenue Code by Section 4(1) of Public Law 106-519, regarding adjustments in computing alternative minimum tax income relating to the exclusion under Section 114 of the Internal Revenue Code, shall not apply.

SEC. 37. Section 23457 of the Revenue and Taxation Code is amended to read:

23457. For purposes of this part, Section 57 of the Internal Revenue Code is modified as follows:

(a) Section 57(a)(5) of the Internal Revenue Code, relating to tax-exempt interest, shall not be applicable.

(b) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference the amount by which the deduction allowable under Section 24348 for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allowable had the taxpayer maintained its bad debt reserve for all taxable years on the basis of actual experience.



(c) Section 57(a)(6) of the Internal Revenue Code, relating to accelerated depreciation or amortization on certain property placed in service before January 1, 1987, is modified to read: With respect to each property as described in Section 1250(c) of the Internal Revenue Code as that provision read on April 1, 1970, the amount by which the deduction allowable for the taxable year for exhaustion, wear, tear, obsolescence, or amortization exceeds the depreciation deduction that would have been allowable for the taxable year, had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life (determined without regard to Section 24354.2 or 24381) for which the taxpayer has held the property.

SEC. 38. Section 23609 of the Revenue and Taxation Code is amended to read:

23609. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the “tax” (as defined by Section 23036) an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each taxable year beginning before January 1, 1997, both of the following modifications shall apply:

(1) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “8 percent.”

(2) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “12 percent.”

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, both of the following modifications shall apply:

(A) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “11 percent.”

(B) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “24 percent.”

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, both of the following shall apply:

(A) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “12 percent.”

(B) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “24 percent.”

(3) For each taxable year beginning on or after January 1, 2000, both of the following shall apply:

(A) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “15 percent.”

(B) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “24 percent.”



(c) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of “qualified research expense” any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) “Qualified research” and “basic research” shall include only research conducted in California.

(d) The provisions of Section 41(e)(7)(A) of the Internal Revenue Code, shall be modified so that “basic research,” for purposes of this section, includes any basic or applied research including scientific inquiry or original investigation for the advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except that the term does not include any of the following:

(1) Basic research conducted outside California.

(2) Basic research in the social sciences, arts, or humanities.

(3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.

(4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(e) (1) In the case of a taxpayer engaged in any biopharmaceutical research activities that are described in codes 2833 to 2836, inclusive, or any research activities that are described in codes 3826, 3829, or 3841 to 3845, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, or any other biotechnology research and development activities, the provisions of Section 41(e)(6) of the Internal Revenue Code shall be modified to include both of the following:

(A) A qualified organization as described in Section 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an institution of higher education as described in Section 3304(f) of the Internal Revenue Code.

(B) A charitable research hospital owned by an organization that is described in Section 501(c)(3) of the Internal Revenue Code, is exempt from taxation under Section 501(a) of the Internal Revenue Code, is not a private foundation, is designated a “specialized laboratory cancer center,” and has received Clinical Cancer Research Center status from the National Cancer Institute.

(2) For purposes of this subdivision:

(A) “Biopharmaceutical research activities” means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide



pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.

(B) “Other biotechnology research and development activities” means research and development activities consisting of the application of recombinant DNA technology to produce commercial products, as well as research and development activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(f) In the case where the credit allowed by this section exceeds the “tax,” the excess may be carried over to reduce the “tax” in the following year, and succeeding years if necessary, until the credit has been exhausted.

(g) For each taxable year beginning on or after January 1, 1998, the reference to “Section 501(a)” in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read “this part or Part 10 (commencing with Section 17001).”

(h) (1) For each taxable year beginning on or after January 1, 2000:

(A) The reference to “2.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “one and forty-nine hundredths of one percent.”

(B) The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read “one and ninety-eight hundredths of one percent.”

(C) The reference to “3.75 percent” in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read “two and forty-eight hundredths of one percent.”

(2) Section 41(c)(4)(B) shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code may be made for any taxable year of the taxpayer beginning on or after January 1, 1998. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

(3) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(i) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.



(j) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (f), except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

SEC. 39. Section 23701s of the Revenue and Taxation Code is amended to read:

23701s. (a) An employee-funded pension trust described in Section 501(c)(18) of the Internal Revenue Code, except as otherwise provided.

(b) The last sentence in Section 501(c)(18) of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), relating to excess contributions under Section 4979, shall not apply.

SEC. 40. Section 23705 of the Revenue and Taxation Code is amended to read:

23705. (a) (1) An organization described in Section 23701i (voluntary employee's beneficiary associations) or 23701q (qualified group legal service plans) which is part of a plan of an employer shall not be exempt from tax under Section 23701, unless that plan meets the requirements of Section 505(b) of the Internal Revenue Code, as amended by Title VI of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16).

(2) Paragraph (1) shall not apply to any organization described in Section 505(a)(2) of the Internal Revenue Code.

(b) A copy of any notice filed with the Secretary of the Treasury, pursuant to Section 505(c) of the Internal Revenue Code, relating to application for tax-exempt status, shall be filed at the same time and in the same manner with the Franchise Tax Board.

SEC. 41. Section 23711 of the Revenue and Taxation Code is amended to read:

23711. Section 529 of the Internal Revenue Code, as amended by Section 402 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 417 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), relating to qualified state tuition programs, shall apply, except as otherwise provided.

(a) Section 529(a) of the Internal Revenue Code is modified as follows:



(1) By substituting the phrase “under Part 10 (commencing with Section 17001) and this part” in lieu of the phrase “under this subtitle.”

(2) By substituting “Article 2 (commencing with Section 23731)” in lieu of “section 511.”

(b) A copy of the report required to be filed with the Secretary of the Treasury under Section 529(d) of the Internal Revenue Code shall be filed with the Franchise Tax Board at the same time and in the same manner as specified in that section.

SEC. 42. Section 23712 of the Revenue and Taxation Code is amended to read:

23712. Section 530 of the Internal Revenue Code, as amended by Sections 401 and 402 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 411 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), relating to education individual retirement accounts, shall apply, except as otherwise provided.

(a) Section 530(a) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase “under Part 10 (commencing with Section 17001) and this part” in lieu of the phrase “under this subtitle.”

(2) By substituting “Article 2 (commencing with Section 23731)” in lieu of “section 511.”

(b) For taxable years beginning before January 1, 2002, Section 530(b)(1) of the Internal Revenue Code, relating to the definition of education individual retirement account, is modified to additionally require that upon the date that the designated beneficiary becomes 30 years of age, any balance to the credit of the beneficiary shall be distributed within 30 days after the date the beneficiary becomes 30 years of age to that beneficiary.

(c) Section 530(d) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase “under Part 10 (commencing with Section 17001) in the manner as provided in Section 72(b) of the Internal Revenue Code, as modified by Part 10” in lieu of the phrase “in the manner as provided in Section 72(b)” in Section 530(d)(1) of the Internal Revenue Code.

(2) (A) A taxpayer that has elected to waive the application of Section 530(d)(2) of the Internal Revenue Code for federal income tax purposes shall be treated as having waived the application of that paragraph for state purposes, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5 or paragraph (3) of subdivision (e) of Section 23051.5, and the federal



election shall be binding for purposes of Part 10 (commencing with Section 17001) and this part.

(B) If a taxpayer fails to make an election under Section 530(d)(2)(C) of the Internal Revenue Code for federal income tax purposes to waive the application of Section 530(d)(2) of the Internal Revenue Code, an election under Section 530(d)(2)(C) of the Internal Revenue Code shall not be allowed for state purposes, Section 530(d)(2)(A) and (B) of the Internal Revenue Code shall apply for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

(3) (A) By substituting the phrase “tax imposed by Part 10 (commencing with Section 17001)” in lieu of the phrase “tax imposed by this chapter” in Section 530(d)(4)(A) of the Internal Revenue Code.

(B) By substituting the phrase “increased by 2¹/₂ percent” in lieu of the phrase “increased by 10 percent” in Section 530(d)(4)(A) of the Internal Revenue Code.

(C) By substituting the phrase “shall be included in the contributor’s gross income under Part 10 (commencing with Section 17001) or this part” in lieu of the phrase “shall be included in gross income” in Section 530(d)(4)(C) of the Internal Revenue Code.

(d) For purposes of Part 10 (commencing with Section 17001) and this part, in the case of a custodial account treated as a trust by reason of Section 530(g) of the Internal Revenue Code, the custodian of that account shall be treated as the trustee thereof.

(e) A copy of the report, which is required to be filed with the Secretary of the Treasury under Section 530(h) of the Internal Revenue Code, shall be filed with the Franchise Tax Board at the same time and in the same manner as specified in that section.

SEC. 43. Section 23801 of the Revenue and Taxation Code is amended to read:

23801. (a) Except as otherwise provided, a corporation that has in effect for federal income tax purposes a valid election under Section 1362(a) of the Internal Revenue Code shall be an “S” corporation for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part.

(b) A corporation that is an “S corporation” for federal income tax purposes, shall be an “S corporation” for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401) and this part, and its shareholders shall be shareholders of an “S corporation” without regard to whether the corporation is qualified to do business or is incorporated in this state.

(c) Notwithstanding subdivision (a), a corporation that elects “S corporation” status under Section 1362 of the Internal Revenue Code for



federal income tax purposes but which is not qualified to be an “S corporation” under subdivision (a) of Section 23800.5, shall not be an “S corporation” for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401, and this part.

(d) Except as provided in subdivision (e), a corporation that is an “S corporation” for purposes of this part shall not be included in a combined report pursuant to Chapter 17 (commencing with Section 25101).

(e) (1) In cases where the Franchise Tax Board determines that the reported income or loss of a group of commonly owned or controlled corporations (within the meaning of Section 25105), which includes one or more corporations treated as an “S corporation” under Chapter 4.5 (commencing with Section 23800), does not clearly reflect income (or loss) of a member of that group or represents an evasion of tax by one or more members of that group, and the Franchise Tax Board determines that the comparable uncontrolled price method prescribed by regulations pursuant to Section 482 of the Internal Revenue Code cannot practically be applied, the Franchise Tax Board may, in lieu of other methods prescribed by regulations pursuant to Section 482 of the Internal Revenue Code, apply methods of unitary combination, pursuant to Article 1 (commencing with Section 25101) of Chapter 17, to properly reflect the income or loss of the members of the group.

(2) The application of the provisions of this subdivision shall not affect the treatment of any corporation as an “S corporation.”

(f) The tax for a “C corporation” for a short year shall be determined in accordance with Chapter 13 (commencing with Section 24631), in lieu of Section 1362(e)(5) of the Internal Revenue Code.

(g) (1) A termination of a federal election pursuant to Section 1362(d) of the Internal Revenue Code, that is not an inadvertent termination pursuant to Section 1362(f) of the Internal Revenue Code, shall simultaneously terminate the “S corporation” election for purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part.

(2) A federal termination by revocation shall be effective for purposes of this part and shall be reported to the Franchise Tax Board in the form and manner prescribed by the Franchise Tax Board no later than the last date allowed for filing federal termination for that year under Section 1362(d) of the Internal Revenue Code.

(h) For taxable years beginning on or after January 1, 1997, for purposes of subparagraph (F) of paragraph (4) of subdivision (a) of this section and Section 1362(g) of the Internal Revenue Code, relating to election after termination, any termination under Section 1362(d) of the Internal Revenue Code or election to be treated as a “C corporation” under subparagraph (A) or (C) of paragraph (4) of subdivision (a), or to



terminate by revocation under paragraph (3) of subdivision (f) in a taxable year beginning before January 1, 1997, shall not be taken into account.

(i) (1) The provisions of Section 1362(b)(5) of the Internal Revenue Code, relating to authority to treat late elections, etc., as timely, shall apply only for taxable years beginning on or after January 1, 1997, with respect to elections under Section 1362(a) of the Internal Revenue Code for taxable years beginning on or after January 1, 1997.

(2) Notwithstanding the provisions of paragraph (1), if for any taxable year beginning on or after January 1, 1987, a corporation fails to qualify as an "S corporation" for federal income tax purposes solely because the federal Form 2553 (Election by a Small Business Corporation) was not filed timely, the corporation shall be treated for purposes of this part as an "S corporation" for the taxable year the "S corporation" election should have been made, and for each subsequent year until terminated, if both of the following conditions are met:

(A) The corporation and all of its shareholders reported their income for California tax purposes on original returns consistent with "S corporation" status for the year the "S corporation" election should have been made, and for each subsequent taxable year (if any) until terminated.

(B) The corporation and its shareholders have filed with the Internal Revenue Service a federal Form 2553 requesting automatic relief with respect to the late "S corporation" election, in full compliance with the federal Revenue Procedure 1997-48, I.R.B. 1997-43, and have received notification of the acceptance of the untimely filed "S corporation" election from the Internal Revenue Service. A copy of the notification shall be provided to the Franchise Tax Board upon request.

(j) The provisions of Section 1362(f) of the Internal Revenue Code, relating to inadvertent invalid elections or terminations, shall apply only for taxable years beginning on or after January 1, 1997, with respect to elections under Section 1362(a) of the Internal Revenue Code for taxable years beginning on or after January 1, 1997.

SEC. 44. Section 23802 of the Revenue and Taxation Code is amended to read:

23802. (a) Section 1363(a) of the Internal Revenue Code, relating to the taxability of an "S corporation," shall not be applicable.

(b) Corporations qualifying under this chapter shall continue to be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except as follows:

(1) The tax imposed under Section 23151 or 23501 shall be imposed at a rate of 1¹/₂ percent rather than the rate specified in those sections.



(2) In the case of an “S corporation” which is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.

(c) An “S corporation” shall be subject to the minimum franchise tax imposed under Section 23153.

(d) (1) For purposes of subdivision (b), an “S corporation” shall be allowed a deduction under Section 24416 or 24416.1 (relating to net operating loss deductions), but only with respect to losses incurred during periods in which the corporation is an “S corporation” for purposes of this part.

(2) Section 1371(b) of the Internal Revenue Code, relating to denial of carryovers between “C years” and “S years,” shall apply for purposes of the tax imposed under subdivision (b), except as provided in paragraph (1).

(3) The provisions of this subdivision shall not affect the amount of any item of income or loss computed in accordance with the provisions of Section 1366 of the Internal Revenue Code, relating to passthrough items to shareholders.

(4) For purposes of subdivision (b) of Section 17276, relating to limitations on loss carryovers, losses passed through to shareholders of an “S corporation,” to the extent otherwise allowable without application of that subdivision, shall be fully included in the net operating loss of that shareholder and then that subdivision shall be applied to the entire net operating loss.

(e) For purposes of computing the taxes specified in subdivision (b), an “S corporation” shall be allowed a deduction from income for built-in gains and passive investment income for which a tax has been imposed under this part in accordance with the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, or Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income.

(f) For purposes of computing taxes imposed under this part, as provided in subdivision (b):

(1) An “S corporation” shall compute its deductions for amortization and depreciation in accordance with the provisions of Part 10 (commencing with Section 17001) of Division 2.

(2) The provisions of Section 465 of the Internal Revenue Code, relating to limitation of deductions to the amount at risk, shall be applied in the same manner as in the case of an individual.

(3) (A) The provisions of Section 469 of the Internal Revenue Code, relating to limitations on passive activity losses and credits, shall be applied in the same manner as in the case of an individual. For purposes



of the tax imposed under Section 23151 or 23501, as modified by this section, material participation shall be determined in accordance with Section 469(h) of the Internal Revenue Code, relating to certain closely held “C corporations” and personal service corporations.

(B) For purposes of this paragraph, the “adjusted gross income” of the “S corporation” shall be equal to its “net income,” as determined under Section 24341 with the modifications required by this subdivision, except that no deduction shall be allowed for contributions allowed by Section 24357.

(4) The exclusion provided under Section 18152.5 shall not be allowed to an “S corporation.”

(g) The provisions of Section 1363(d) of the Internal Revenue Code, relating to recapture of LIFO benefits, shall be modified for purposes of this part to refer to Section 19101 in lieu of Section 6601 of the Internal Revenue Code.

SEC. 45. Section 23811 of the Revenue and Taxation Code is amended to read:

23811. Except as otherwise provided in this section, there is hereby imposed a tax on passive investment income attributable to California sources, determined in accordance with the provisions of Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income, as modified by this section.

(a) The tax imposed under this section shall not be imposed on an “S corporation” that has no excess net passive income for federal income tax purposes determined in accordance with Section 1375 of the Internal Revenue Code.

(b) (1) The rate of tax shall be equal to the rate of tax imposed under Section 23151 in lieu of Section 11(b) of the Internal Revenue Code.

(2) In the case of an “S corporation” which is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151.

(c) The provisions of Section 1375(c)(1) of the Internal Revenue Code, relating to credits, shall be modified to provide that the tax imposed under subdivision (a) shall not be reduced by any credits allowed under this part.

(d) The term “subchapter C earnings and profits” as used in Sections 1362(d)(3) and 1375 of the Internal Revenue Code shall mean the subchapter C earnings and profits of the corporation attributable to California sources determined under this part, modified as provided in subdivision (e).

(e) (1) In the case of a corporation which is an “S corporation” for purposes of this part for its first taxable year for which it has in effect a



valid federal S election, there shall be allowed as a deduction in determining that corporation's subchapter C earnings and profits at the close of any taxable year the amount of any consent dividend (as provided in paragraph (2)) paid after the close of that taxable year.

(2) In the event there is a determination that a corporation described in paragraph (1) has subchapter C earnings and profits at the close of any taxable year, that corporation shall be entitled to distribute a consent dividend to its shareholders. The amount of the consent dividend shall not exceed the difference between the corporation's subchapter C earnings and profits determined under subdivision (d) at the close of the taxable year with respect to which the determination is made and the corporation's subchapter C earnings and profits for federal income tax purposes at the same date. A consent dividend must be paid within 90 days of the date of the determination that the corporation has subchapter C earnings and profits. For this purpose, the date of a determination means the effective date of a closing agreement pursuant to Section 19441, the date an assessment of tax imposed by this section becomes final, or the date of execution by the corporation of an agreement with the Franchise Tax Board relating to liability for the tax imposed by this section. For purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, a corporation must make the election provided in Section 1368(e)(3) of the Internal Revenue Code.

(3) If a corporation distributes a consent dividend, it shall claim the deduction provided in paragraph (1) by filing a claim therefor with the Franchise Tax Board within 120 days of the date of the determination specified in paragraph (2).

(4) The collection of tax imposed by this section from a corporation described in paragraph (2) shall be stayed for 120 days after the date of the determination specified in paragraph (2). If a claim is filed pursuant to paragraph (3), collection of that tax shall be further stayed until the date the claim is acted upon by the Franchise Tax Board.

(5) If a claim is filed pursuant to paragraph (3), the running of the statute of limitations on the making of assessments and actions for collection of the tax imposed by this section shall be suspended for a period of two years after the date of the determination specified in paragraph (2).

SEC. 46. Section 24306 of the Revenue and Taxation Code is amended to read:

24306. (a) For purposes of this section, the following terms have the following meanings, as provided in the Golden State Scholarshare Trust Act (Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code):



(1) “Beneficiary” has the meaning set forth in subdivision (c) of Section 69980 of the Education Code.

(2) “Benefit” has the meaning set forth in subdivision (d) of Section 69980 of the Education Code.

(3) “Participant” has the meaning set forth in subdivision (h) of Section 69980 of the Education Code.

(4) “Participation agreement” has the meaning set forth in subdivision (i) of Section 69980 of the Education Code.

(5) “Scholarshare trust” has the meaning set forth in subdivision (f) of Section 69980 of the Education Code.

(b) Except as otherwise provided in subdivision (c), gross income of a participant shall not include any of the following:

(1) Any earnings under a Scholarshare trust, or a participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(2) Contributions to the Scholarshare trust on behalf of a beneficiary shall not be includable as gross income of that beneficiary.

(c) (1) Any distribution under a Scholarshare trust participation agreement shall be includable in the gross income of the distributee in the manner as provided under Section 72 of the Internal Revenue Code, as modified by Section 24272.2, to the extent not excluded from gross income under any other provision of this part. For purposes of applying Section 72 of the Internal Revenue Code, the following apply:

(A) All Scholarshare trust accounts of which an individual is a beneficiary shall be treated as one account, except as otherwise provided.

(B) All distributions during a taxable year shall be treated as one distribution.

(C) The value of the participation agreement, income on the participation agreement, and investment in the participation agreement shall be computed as of the close of the calendar year in which the taxable year begins.

(2) A contribution by a for-profit or nonprofit entity, or by a state or local government agency, for the benefit of an owner or employee of that entity or a beneficiary whom the owner or employee has the power to designate, including the owner or employee’s minor children, shall be included in the gross income of that owner or employee in the year the contribution is made.

(3) For purposes of this subdivision, “distribution” includes any benefit furnished to a beneficiary under a participation agreement, as provided in Article 19 (commencing with Section 69980) of Chapter 2 of Part 42 of the Education Code.

(4) (A) Paragraph (1) shall not apply to that portion of any distribution that, within 60 days of distribution, is transferred to the



credit of another beneficiary under the Scholarshare trust who is a “member of the family,” as that term is used in Section 529(e)(2) of the Internal Revenue Code, as amended by Section 211 of the Taxpayer Relief Act of 1997 (Public Law 105-34), of the former beneficiary of that Scholarshare trust.

(B) Any change in the beneficiary of an interest in the Scholarshare trust shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a “member of the family,” as that term is used in Section 2032A(e)(2) of the Internal Revenue Code, of the former beneficiary of that Scholarshare trust.

(d) For taxable years beginning on or after January 1, 2002, Sections 529(c) and 529(e) of the Internal Revenue Code, as amended by Section 402 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Section 417 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), shall apply in lieu of subdivisions (b) and (c) of this section.

SEC. 47. Section 24307 of the Revenue and Taxation Code is amended to read:

24307. (a) Section 108 of the Internal Revenue Code, relating to income from discharge of indebtedness, shall apply, except as otherwise provided.

(b) Section 108(b)(2)(B) of the Internal Revenue Code, relating to general business credit, is modified by substituting “this part” in lieu of “Section 38 (relating to general business credit).”

(c) Section 108(b)(2)(G) of the Internal Revenue Code, relating to foreign tax credit carryovers, shall not apply.

(d) Section 108(b)(3)(B) of the Internal Revenue Code, relating to credit carryover reduction, is modified by substituting “11.1 cents” in lieu of “33¹/₃ cents” in each place in which it appears. In the case where more than one credit is allowable under this part, the credits shall be reduced on a pro rata basis.

(e) Section 108(g)(3)(B) of the Internal Revenue Code, relating to adjusted tax attributes, is modified by substituting “\$9” in lieu of “\$3.”

(f) (1) The amendments to Section 108 of the Internal Revenue Code made by Section 13150 of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to exclusion from gross income for income from discharge of qualified real property business indebtedness, shall apply to discharges occurring on or after January 1, 1996, in taxable years beginning on or after January 1, 1996.

(2) If a taxpayer makes an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, a separate election shall not be allowed under paragraph (3) of subdivision (e) of



Section 23051.5 and the federal election shall be binding for purposes of this part.

(3) If a taxpayer has not made an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, then the taxpayer shall not be allowed to make that election for purposes of this part.

(g) The amendments to Section 108 of the Internal Revenue Code made by Section 13226 of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to modifications of discharge of indebtedness provisions, shall apply to discharges occurring on or after January 1, 1996, in taxable years beginning on or after January 1, 1996.

(h) The amendments made to Section 108(d)(7)(A) of the Internal Revenue Code, relating to certain provisions to be applied at the corporate level by Section 402 of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), shall apply to discharges of indebtedness after December 31, 2001, in taxable years ending after that date. This subdivision shall not apply to any discharge of indebtedness made before March 1, 2002, pursuant to a plan of reorganization filed with a bankruptcy court on or before October 11, 2001.

SEC. 48. Section 24343.7 of the Revenue and Taxation Code is amended to read:

24343.7. Section 162(k)(2)(A)(ii) of the Internal Revenue Code shall not apply.

SEC. 49. Section 24357 of the Revenue and Taxation Code is amended to read:

24357. (a) There shall be allowed as a deduction any charitable contribution (as defined in Section 24359) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Franchise Tax Board.

(b) (1) In the case of a corporation reporting its income on the accrual basis, the corporation may elect to treat the contribution as paid during that taxable year if both of the following occur:

(A) The board of directors authorizes a charitable contribution during the taxable year.

(B) Payment of the contribution is made after the close of that taxable year and on or before the 15th day of the third month following the close of the taxable year.

(2) The election allowed by paragraph (1) may be made only at the time of the filing of the return for the taxable year, and shall be signified in the manner as the Franchise Tax Board shall by regulations prescribe.



(c) For purposes of this section, payment of a charitable contribution that consists of a future interest in tangible personal property shall be treated as made only when all intervening interests in, and rights to the actual possession or enjoyment of, the property have expired or are held by persons other than the taxpayer or those standing in a relationship to the taxpayer described in Section 24428. For purposes of the preceding sentence, a fixture which is intended to be severed from the real property shall be treated as tangible personal property.

(d) No deduction shall be allowed under this section for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in that travel.

(e) (1) Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions, shall apply, except as otherwise provided.

(2) No deduction shall be denied under Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions, upon a showing that the requirements in Section 170(f)(8) of the Internal Revenue Code have been met with respect to that contribution for federal purposes.

(f) Section 170(f)(9) of the Internal Revenue Code, relating to the denial of the deduction for lobbying activities shall apply, except as otherwise provided.

SEC. 50. Section 24357.9 of the Revenue and Taxation Code is amended to read:

24357.9. (a) In the case of a qualified computer contribution, the amount otherwise allowed as a deduction under Section 24357 shall be reduced by that amount of the reduction provided by Section 24357.1 that is no greater than the sum of the following:

(1) One-half of the amount computed pursuant to Section 24357.1 (computed without regard to this paragraph).

(2) The amount (if any) by which the charitable contribution deduction under this section for any qualified computer contribution (computed by taking into account the amount determined by paragraph (1), but without regard to this paragraph) exceeds twice the basis of the property.

(b) For purposes of this section, the term “qualified computer contribution” means a charitable contribution by a corporation of any computer technology or equipment, but only if all of the following apply:

(1) The contribution is to either of the following:



(A) An educational organization described in Section 170(b)(1)(A)(ii) of the Internal Revenue Code.

(B) An entity described in Section 23701d and exempt from tax under Section 23701 (other than an entity described in subparagraph (A)) that is organized primarily for purposes of supporting elementary and secondary education in California.

(C) A public library (as described in Section 170(e)(6)(B)(i)(III) of the Internal Revenue Code).

(2) The contribution is made not later than three years after the date the taxpayer acquired the property (or in the case of property constructed by the taxpayer, the date the construction of the property is substantially completed).

(3) The original use of the property is by the donor or the donee.

(4) Substantially all of the use of the property by the donee is for use within California for educational purposes in any of the grades K through 12 that are related to the purpose or function of the organization or entity.

(5) The property is not transferred by the donee in exchange for money, other property, or services, except for shipping, installation, and transfer of costs.

(6) The property will fit productively into the entity's educational plan.

(7) The entity's use and disposition of the property will be in accordance with paragraphs (4) and (5).

(8) The property meets the standards, if any, as the Secretary of the Treasury may have prescribed by regulation under Section 170(e)(6) of the Internal Revenue Code to assure that the property meets minimum functionality and suitability standards for educational purposes.

(c) A contribution by a corporation of any computer technology or equipment to a private foundation (as defined in Section 509 of the Internal Revenue Code) shall be treated as a qualified computer contribution for purposes of this section if both of the following apply:

(1) The contribution to the private foundation satisfies the requirements of paragraphs (2) and (5) of subdivision (b).

(2) Within 30 days after that contribution, the private foundation does both of the following:

(A) Contributes the property to an entity described in paragraph (1) of subdivision (b) that satisfies the requirements of paragraphs (4) to (7), inclusive, of subdivision (b).

(B) Notifies the donor of that contribution.

(d) In the case of property that is reacquired by the person who constructed the property, both of the following shall apply:



(1) Paragraph (2) of subdivision (b) shall be applied to a contribution of that property by that person by taking into account the date that the original construction of the property was substantially completed.

(2) Paragraph (3) of subdivision (b) shall not apply to that contribution.

(e) For purposes of this section, property shall be treated as constructed by the taxpayer only if the cost of the parts used in the construction of that property (other than parts manufactured by the taxpayer or a related person) do not exceed 50 percent of the taxpayer's basis in that property.

(f) For purposes of this section:

(1) "Computer technology or equipment" means computer software (as defined by Section 197(e)(3)(B) of the Internal Revenue Code), computer or peripheral equipment (as defined by Section 168(i)(2)(B) of the Internal Revenue Code), and fiber-optic cable related to computer use.

(2) "Corporation" shall not include any of the following:

(A) An "S corporation."

(B) A personal holding company (as defined in Section 542 of the Internal Revenue Code).

(C) A service organization (as defined in Section 414(m)(3) of the Internal Revenue Code).

(g) (1) This section shall not apply to any contribution made during any taxable year beginning on or after January 1, 2000, and before December 31, 2001.

(2) This section shall not apply to any contributions made during any taxable year beginning after December 31, 2003.

SEC. 51. Section 24424 of the Revenue and Taxation Code is repealed.

SEC. 52. Section 24424 is added to the Revenue and Taxation Code, to read:

24424. Section 264 of the Internal Revenue Code, relating to certain amounts paid in connection with insurance contracts, shall apply, except as otherwise provided.

SEC. 53. Section 24443 of the Revenue and Taxation Code is amended to read:

24443. Section 274 of the Internal Revenue Code, relating to the disallowance of certain entertainment, gift, travel, etc., expenses, shall apply, except as otherwise provided.

SEC. 54. Section 24661.3 is added to the Revenue and Taxation Code, to read:

24661.3. (a) (1) The options under Sections 112(d)(2) and 112(d)(3) of the Federal Agriculture Improvement and Reform Act of



1996 (7 U.S.C. Sec. 7212(d)(2) and (3)), as in effect on October 12, 1998, shall be disregarded in determining the taxable year for which any payment under a production flexibility contract under Subtitle B of Title I of that act (as so in effect) is properly includable in gross income for purposes of this part, Part 10 (commencing with Section 17001), or Part 10.2 (commencing with Section 18401).

(2) In order to provide farmers with the same tax treatment for all payments in years beginning before January 1, 2002, with respect to production flexibility contract payments as provided under federal law as modified by Public Law 105-277, this subdivision shall apply to taxable years ending after December 31, 1995.

(b) Any option to accelerate the receipt of any payment under a production flexibility contract entered into on or after January 1, 2002, that is payable under the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. Sec. 7200 et seq.) as in effect on December 17, 1999, shall be disregarded in determining the taxable year for which that payment is properly includable in gross income for purposes of this part, Part 10 (commencing with Section 17001), or Part 10.2 (commencing with Section 18401).

SEC. 55. Section 24667 of the Revenue and Taxation Code is amended to read:

24667. (a) (1) Sections 453, 453A, and 453B of the Internal Revenue Code, relating to installment method, special rules for nondealers, and gain or loss on disposition of installment obligations, respectively, shall apply, except as otherwise provided.

(2) Sections 811(c)(4), 811(c)(6), and 811(c)(7) of Public Law 99-514, as modified by Section 1008(f) of Public Law 100-647, shall apply to each taxable year beginning on or after January 1, 1988.

(3) Section 812 of Public Law 99-514, relating to the disallowance of use of the installment method for certain obligations, as modified by Section 1008(g) of Public Law 100-647, shall apply to each taxable year beginning on or after January 1, 1988.

(b) For purposes of subdivision (a), any references in the Internal Revenue Code to sections that have not been incorporated into this part by reference shall be deemed to refer to the corresponding section, if any, of this part.

(c) In the case of any taxpayer who made sales under a revolving credit plan and was on the installment method under former Section 24667 or 24668 for the taxpayer's last taxable year beginning before January 1, 1988, the provisions of this section shall be treated as a change in method of accounting for the first taxable year beginning after December 31, 1987, and all of the following shall apply:

(1) That change shall be treated as initiated by taxpayer.



(2) That change shall be treated as having been made with the consent of the Franchise Tax Board.

(3) The period for taking into account adjustments under Article 6 (commencing with Section 24721) by reason of that change shall not exceed four years.

(d) The repeal of Section 453C of the Internal Revenue Code by Section 10202(a) of Public Law 100-203, relating to repeal of the proportionate disallowance of the installment method, shall apply to dispositions on or after January 1, 1990, in taxable years beginning on or after January 1, 1990.

(e) (1) In the case of any installment obligations to which Section 453(l)(2)(B) of the Internal Revenue Code applies, in lieu of the provisions of Section 453(l)(3)(A) of the Internal Revenue Code, the “tax” (as defined by subdivision (a) of Section 23036) for any taxable year for which payment is received on that obligation shall be increased by the amount of interest determined in the manner provided under Section 453(l)(3)(B) of the Internal Revenue Code.

(2) Sections 10202 and 10204 of Public Law 100-203, are modified to provide for each of the following:

(A) Section 10202 shall apply to dispositions in taxable years beginning on or after January 1, 1990.

(B) Section 10204 shall apply to costs incurred in taxable years beginning on or after January 1, 1990.

(C) Any adjustments required by Section 481 of the Internal Revenue Code shall be included in gross income as follows:

(i) Fifty percent in the first taxable year beginning on or after January 1, 1990.

(ii) Fifty percent in the second taxable year beginning on or after January 1, 1990.

(f) (1) The amendments to Section 453A of the Internal Revenue Code made by Section 2004 of Public Law 100-647, relating to special rules for nondealers, shall apply to each taxable year beginning on or after January 1, 1990.

(2) In the case of any installment obligation to which Section 453A of the Internal Revenue Code applies and which is outstanding as of the close of the taxable year, in lieu of the provisions of Section 453A(c)(1) of the Internal Revenue Code, the “tax” (as defined by subdivision (a) of Section 23036) for the taxable year shall be increased by the amount of interest determined in the manner provided under Section 453A(c)(2) of the Internal Revenue Code.

(3) The provisions of Section 453A(c)(3)(B) of the Internal Revenue Code, relating to the maximum rate used in calculating the deferred tax liability, are modified to refer to the maximum rate of tax imposed under



Section 23151, 23186, or 23802, whichever applies, in lieu of the maximum rate of tax imposed under Section 1 or 11 of the Internal Revenue Code.

(g) (1) The last sentence of Section 453A(d)(4) of the Internal Revenue Code, relating to secured indebtedness, shall not apply.

(2) This subdivision shall apply to sales or other dispositions occurring on or after January 1, 2002.

SEC. 56. Section 24685.5 is added to the Revenue and Taxation Code, to read:

24685.5. (a) The amendment made by Section 7001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) to Section 404(a)(11) of the Internal Revenue Code, regarding determinations relating to deferred compensation, shall apply to taxable years beginning on or after January 1, 2002.

(b) In the case of any taxpayer required by enactment of this section to change its method of accounting, for that taxpayer's first taxable year beginning on or after January 1, 2002, each of the following shall apply for purposes of this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401):

(1) The change shall be treated as initiated by the taxpayer.

(2) The change shall be treated as made with the consent of the Franchise Tax Board.

(3) The net amount of the adjustments required to be taken into account by the taxpayer under Chapter 13 (commencing with Section 24631) shall be taken into account ratably over the three-taxable-year period beginning with that taxpayer's first taxable year beginning on or after January 1, 2002.

SEC. 57. Section 24710 of the Revenue and Taxation Code is amended to read:

24710. (a) For each taxable year beginning on or after January 1, 1997, Section 475 of the Internal Revenue Code, relating to mark to market accounting method for securities dealers, shall apply, except as otherwise provided.

(b) Section 13233(c)(2)(C) of the Revenue Reconciliation Act of 1993 (Public Law 103-66), relating to the effective date for changes in the mark to market accounting method for securities dealers, is modified to provide that the amount taken into account under Section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the five-taxable-year period beginning with the first taxable year beginning on or after January 1, 1997.

(c) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 475(e) of the Internal Revenue Code, relating to election of mark to market for dealers in commodities, to have Section



475 of the Internal Revenue Code apply, Section 475 of the Internal Revenue Code shall apply to that dealer in commodities for state purposes, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5, and the federal election shall be binding for purposes of this part.

(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(e) of the Internal Revenue Code, relating to election of mark to market for dealers in commodities, to have Section 475 of the Internal Revenue Code apply, an election under Section 475(e) of the Internal Revenue Code shall not be allowed for state purposes, Section 475 of the Internal Revenue Code shall not apply to that dealer in commodities for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.

(d) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 475(f)(1) of the Internal Revenue Code, relating to election of mark to market for traders in securities, to have Section 475 of the Internal Revenue Code apply to a trade or business, Section 475 of the Internal Revenue Code shall apply to that trader in securities for state purposes with respect to that trade or business, a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5, and the federal election shall be binding for purposes of this part.

(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(f)(1) of the Internal Revenue Code, relating to election of mark to market for traders in securities, to have Section 475 of the Internal Revenue Code apply to a trade or business, an election under Section 475(f)(1) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in securities for state purposes with respect to that trade or business, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.

(e) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply to a trade or business, Section 475 of the Internal Revenue Code shall apply to that trader in commodities for state purposes with respect to that trade or business, a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5, and the federal election with respect to that trade or business shall be binding for purposes of this part.



(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply to a trade or business, an election under Section 475(f)(2) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in commodities for state purposes with respect to that trade or business, and a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.

(f) (1) An election under Section 475(e) or (f) of the Internal Revenue Code made for federal purposes with respect to a taxable year beginning before January 1, 1998, shall be treated as having been made for state purposes with respect to the first taxable year beginning on or after January 1, 1998.

(2) Section 1001(d)(4)(B) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to the effective date for election of mark to market by securities traders and traders and dealers in commodities, is modified to provide that the requirement for timely identification shall be treated as timely made for state purposes if that identification is treated as timely made for federal purposes, and the amount taken into account under Section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the four-taxable-year period beginning with the first taxable year beginning on or after January 1, 1998.

(g) In the case of any taxpayer required to change its method of accounting by the enactment of the act amending this subdivision, incorporating by reference to the amendments made by Section 7003 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) to Section 475 of the Internal Revenue Code, each of the following shall apply for purposes of this part, Part 10 (commencing with Section 17001), or Part 10.2 (commencing with Section 18401):

(1) The change shall be treated as initiated by the taxpayer.

(2) The change shall be treated as made with the consent of the Franchise Tax Board.

(3) The taxpayer shall not be required to change its method of accounting until the first taxable year beginning on or after January 1, 2002.

(4) The net amount of the adjustments required to be taken into account by the taxpayer under Chapter 13 (commencing with Section 24631) shall be taken into account ratably over the three-taxable-year



period beginning with that taxpayer's first taxable year beginning on or after January 1, 2002.

SEC. 58. Section 24942 of the Revenue and Taxation Code is amended to read:

24942. (a) No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of that corporation. No gain or loss shall be recognized by a corporation with respect to any lapse or acquisition of an option, or with respect to a securities futures contract (as defined in Section 1234B of the Internal Revenue Code, to buy or sell its stock (including treasury stock).

(b) For basis of property acquired by a corporation in certain exchanges for its stock, see Sections 24552 to 24554, inclusive.

SEC. 59. Section 24949.1 of the Revenue and Taxation Code, as amended by Section 98 of Chapter 322 of the Statutes of 1998, is repealed.

SEC. 60. Section 24949.1 of the Revenue and Taxation Code, as added by Chapter 846 of the Statutes of 1961, is amended to read:

24949.1. For purposes of this part, the sale or exchange of livestock (other than poultry) held by a taxpayer for draft, breeding, or dairy purposes in excess of the number the taxpayer would sell if he or she followed his or her usual business practices shall be treated as an involuntary conversion to which Sections 24943 to 24949, inclusive, apply if the livestock are sold or exchanged by the taxpayer solely on account of drought, flood, or other weather-related conditions.

SEC. 61. In order to provide employers and employees with the same tax treatment for all years with respect to meals or lodging furnished for the convenience of the employer as under federal law, amendments made by the enactment of this act, which incorporates by reference the amendments made by Section 5002 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206) to Section 119 of the Internal Revenue Code, shall apply to taxable years beginning before, on, or after July 22, 1998.

SEC. 62. Sections 6001 to 6024, inclusive, of the Internal Revenue Service Restructuring and Reform Act of 1998 (Title VI of Public Law 105-206), Sections 4001 to 4006, inclusive, of the Tax and Trade Relief Extension Act of 1998 (Title IV of Division J of Public Law 105-277), Sections 311 to 319, inclusive, of the Consolidated Appropriations Act, 2001 (Subtitle B of Title III of Public Law 106-554), and Sections 412 to 417, inclusive, of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147) enacted numerous technical corrections to provisions of the Internal Revenue Code, including technical corrections relating to the Consolidated Appropriations Act, 2001 (Public Law



106-554), the Tax Relief Extension Act of 1999 (Public Law 106-170), the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277), the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206), the Balanced Budget Act of 1997 (Public Law 105-33), the Taxpayer Relief Act of 1997 (Public Law 105-34), the Small Business Job Protection Act of 1996 (Public Law 104-188), the Uruguay Round Agreements Act (Public Law 103-465), the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66), the Revenue Reconciliation Act of 1990 (Public Law 101-508), the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647), the Tax Reform Act of 1986 (Public Law 99-514), and the Tax Reform Act of 1984 (Public Law 98-369), some of which are incorporated by specific reference into Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code. Unless otherwise specifically provided, the technical corrections described in the preceding sentence, to the extent that they correct provisions that are incorporated by specific reference into the Revenue and Taxation Code, are declaratory of existing law and shall be applied in the same manner and for the same periods as specified in the Internal Revenue Service Restructuring and Reform Act of 1998 (Title VI of Public Law 105-206), the Tax and Trade Relief Extension Act of 1998 (Title IV of Division J of Public Law 105-277), the Consolidated Appropriations Act, 2001 (Subtitle B of Title III of Public Law 106-554), and the Job Creation and Worker Assistance Act of 2002 (Subtitle B of Title IV of Public Law 107-147) or if later, the specified date of incorporation.

SEC. 63. The amendments made to Section 17731.5 by this act are declaratory of existing law and shall be applied in the same manner and for the same taxable years as the amendments made by Section 6007(f)(2) of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206), unless those amendments specifically apply for federal purposes to a date prior to the specified date of incorporation, in which case they shall apply as of the specified date of incorporation.

SEC. 64. The amendments made to Section 17751 by this act are declaratory of existing law and shall be applied in the same manner and for the same taxable years as the amendments made by Section 6013(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206), unless those amendments specifically apply for federal purposes to a date prior to the specified date of incorporation, in which case they shall apply as of the specified date of incorporation.



SEC. 65. The amendments made to Section 18038.5 by this act are declaratory of existing law and shall be applied in the same manner and for the same taxable years as the amendments made by Section 6005(f) of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206), unless those amendments specifically apply for federal purposes to a date prior to the specified date of incorporation, in which case they shall apply as of the specified date of incorporation.

SEC. 66. Amendments made by the enactment of this act, which incorporate by reference the amendments made by Section 3001 of the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277) to Sections 332 and 334 of the Internal Revenue Code, shall apply to distributions made on or after January 1, 2002.

SEC. 67. In order to provide the same tax treatment for all years with respect to the tax treatment of a cash option for qualified prizes as under federal law, as modified by Public Law 105-277:

(a) Amendments made by the enactment of this act, which incorporates by reference the amendments made by Section 5301 of the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277) to Section 451 of the Internal Revenue Code, shall apply to any prize to which a person first becomes entitled after October 21, 1998.

(b) Amendments made by the enactment of this act, which incorporates by reference the amendments made by Section 5301 of the Tax and Trade Relief Extension Act of 1998 (Public Law 105-277) to Section 451 of the Internal Revenue Code, shall apply to any prize to which a person first becomes entitled on or before October 21, 1998, except that in determining whether an option is a qualified prize option as defined in Section 451(h)(2)(A) of the Internal Revenue Code:

(1) Section 451(h)(2)(A)(ii) of the Internal Revenue Code shall not apply.

(2) That option shall be treated as a qualified prize option if it is exercisable only during all or part of the 18-month period beginning on July 1, 1999.

SEC. 68. Amendments made by the enactment of this act, which incorporate by reference the amendments made by Section 3001 of the Miscellaneous Trade and Technical Corrections Act of 1999 (Public Law 106-36) to Sections 351, 357, 358, 362, 368, 584, and 1031 of the Internal Revenue Code, shall apply to transfers made on or after January 1, 2002.

SEC. 69. Section 502(d) of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), relating to special rules delaying the claiming of the research credit, shall not apply.

SEC. 70. Amendments made by the enactment of this act, which incorporate by reference the amendments made by Section 532 of the



Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), shall apply to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired, on or after January 1, 2002.

SEC. 71. Amendments made by the enactment of this act, which incorporate by reference the amendments made by Section 534 of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), which added Section 1260 of the Internal Revenue Code to Subchapter P of Chapter 1 of the Internal Revenue Code, shall apply to transactions entered into on or after January 1, 2002.

SEC. 72. Amendments made by the enactment of this act, which incorporate by reference the amendments made by Section 537 of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170) to Section 170 of the Internal Revenue Code, shall apply to transfers made on or after January 1, 2002.

SEC. 73. In order to provide the same tax treatment under Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code, with respect to distributions by a partnership to a corporate partner, each of the following shall apply:

(a) Except as provided in subdivision (b), amendments made by the enactment of this act, which incorporate by reference the amendments made by Section 538 of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170) to Section 732 of the Internal Revenue Code, shall apply to distributions made on or after January 1, 2002.

(b) (1) In the case of a corporation which is a partner in a partnership as of January 1, 2002, the amendment made by Section 538 of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170) to Section 732 of the Internal Revenue Code, shall apply to any distribution made (or treated as made) to that partner from that partnership after June 30, 2002.

(2) (A) Paragraph (1) shall not apply to any distribution unless the partner has made the election under Section 538(b)(2) of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170) to have Section 538(b)(2) of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170) apply for federal purposes to that distribution on the partner's return of federal income tax for the taxable year in which the distribution occurs.

(B) For purposes of subparagraph (A) of this paragraph, no separate election shall be allowed under paragraph (3) of subdivision (e) of Section 17024.5 or paragraph (3) of subdivision (e) of Section 23051.5.



SEC. 74. Amendments made by the enactment of this act to Section 24357.9 shall apply to a qualified computer contribution made on or after January 1, 2002.

SEC. 75. In order to provide the same tax treatment under Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001) of Division 2 of the Revenue and Taxation Code, with respect to the sale or exchange of livestock sold or exchanged solely on account of flood or other weather-related conditions, the amendments made to Section 24949.1 of the Revenue and Taxation Code, as added by Chapter 846 of the Statutes of 1961, shall apply to taxable years beginning on or after January 1, 1999.

SEC. 76. If a corporation that had in effect a valid federal election to be treated as an “S” corporation for federal purposes and a valid state election to be a “C” corporation for state purposes for taxable years beginning before January 1, 2002, is an “S” corporation pursuant to Section 23801 as amended by this act, the effective date of the election to be treated as an “S” corporation for state purposes shall be January 1, 2002.

SEC. 77. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect. Sections 17085, 17140, 17140.3, 17144.5, 17205, 17501, 17551, 23701s, 23705, 23711, 23712, and 24306 of the Revenue and Taxation Code, as amended or added by this act, conform, in whole or in part, to the changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) and Subtitle IV of the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), to the Internal Revenue Code and shall be operative with respect to the same period, as the federal law provision to which it conforms.

SEC. 78. This act shall become operative only if Assembly Bill 1122 of the 2001–02 Regular Session is chaptered.

