Assembly Bill No. 115

CHAPTER 691

An act to amend Sections 17024.5, 17052.6, 17072, 17077, 17085, 17131, 17132.5, 17140, 17140.3, 17144, 17152, 17220, 17250, 17250.5, 17255, 17256, 17279.4, 17501, 17551, 17731, 17733, 18571, 18572, 18628, 18633, 18648, 19008, 19041.5, 19116, 19164, 19166, 19173, 19177, 19179, 19182, 19184, 23051.5, 23701s, 23701w, 23703.5, 23705, 23711, 23712, 24306, 24349, 24356, 24369.4, 24407, 24601, 24654, 24661.5, 24872, 24949.1, and 24949.3 of, to amend and repeal Sections 17204, 19772, 19774, and 19777 of, to add Sections 17131.4, 17131.5, 17131.6, 17139.6, 17201.4, 17201.5, 17201.6, 17204.7, 17215.1, 17215.4, 17681.6, 17734.6, 17760, 18035.6, 18036.6, 18181, 19136.12, 19164.5, 24355.3, 24355.4, 24406.6, 24661.6, 24694, and 24831.6 to, to add and repeal Sections 17053.62, 17255.5, 23662, and 24356.4 of, to repeal Sections 17131.8, 17136.5, 17137, 17144.5, 17160.5, 17202.5, 17205, 19773, and 24356.5 of, and to repeal and amend Section 19559 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

[Approved by Governor October 7, 2005. Filed with Secretary of State October 7, 2005.]

LEGISLATIVE COUNSEL'S DIGEST

AB 115, Klehs. Taxation: federal conformity.

Under the Personal Income Tax Law and the 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, 2002, the specified date of those referenced Internal Revenue Code sections is January 1, 2001, 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, 2005, for taxable years beginning on or after January 1, 2005, and thereby would make numerous substantive changes to both the Personal Income Tax Law and the Corporation Tax

Law with respect to those areas of preexisting conformity that are subject to changes under federal laws enacted after January 1, 2002, 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 Corporation Tax Law, or both, with respect to, among other things, the exclusion from income of qualified foster care payments, health savings accounts, certain definitions, expensing for small businesses, low-income community tax credits, shareholder treatment, eligible shareholders, transfers of suspended losses incident to divorce, repayment of loans for qualifying employer securities, phaseouts of certain motor fuel excise taxes, suspension of occupational taxes relating to certain alcoholic beverages, information reporting for certain individuals, capital gain treatment applying to outright sales for landowners, expenses of rural letter carriers, expensing of certain reforestation expenditures, depreciation of certain Alaskan pipeline property, interest expense allocation rules, translation of foreign taxes, certain passive foreign investment companies, deductions for certain expenses incurred by corporate taxpayers, Alaska Native Settlement trusts, civil rights tax relief, tax shelter provisions, underpayment penalty, and specified federal acts. This bill would specify various dates on which specified provisions apply, make findings and declarations that certain provisions are declaratory of existing law, specify the intent and operation in the application of provisions conforming to various federal acts, and repeal obsolete provisions.

The Personal Income Tax Law and the Corporation Tax Law authorize various deductions and credits in computing the taxes imposed by those laws.

This bill would, under both laws, for taxable years beginning on or after July 1, 2005, and before January 1, 2018, allow an environmental tax credit in an amount equal to 5¢ for each gallon of ultra low sulfur diesel fuel produced by a small refiner, as defined, at any facility located in this state.

This bill would also, under both laws, for a period beginning on January 1, 2005, and ending on January 1, 2009, authorize a small refiner to elect to treat 75% of qualified capital costs, as defined, as expenses not chargeable to a capital account and expenses that may be deducted, as provided.

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, and on or before December 31, 2004..... January 1, 2001
(N) For taxable years beginning on or after January 1, 2005..... January 1, 2005

(2) (A) 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.

(B) In the case where Section 901 of the Economic Growth and Tax Relief Act of 2001 (Public Law 107-16) applies to any provision of the Internal Revenue Code that is incorporated for purposes of this part, Section 901 of the Economic Growth and Tax Relief Act of 2001 shall apply for purposes of this part in the same manner and to the same taxable years as it applies for federal income tax purposes.

(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 is not 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 Section 172 of the Tax Reform Act of 1984 (Public Law 98-369), relating to treatment of debt instruments, is not 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, is not 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) (A) Except as provided in subparagraph (B), in order 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.

(B) (i) If a taxpayer makes a proper election for federal income tax purposes prior to the time that taxpayer becomes subject to the tax imposed under this part or Part 11 (commencing with Section 23001), that taxpayer is deemed to have made the same election for purposes of the tax imposed by this part, Part 10.2 (commencing with Section 18401), and Part 11 (commencing with Section 23001), as applicable, and that taxpayer may not make a separate election for California tax purposes unless that separate election is expressly authorized by this part, Part 10.2

(commencing with Section 18401), or Part 11 (commencing with Section 23001), or by regulations issued by the Franchise Tax Board.

(ii) If a taxpayer has not made a proper election for federal income tax purposes prior to the time that taxpayer becomes subject to tax under this part or Part 11 (commencing with Section 23001), that taxpayer may not make a separate California election for purposes of this part, Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001), unless that separate election is expressly authorized by this part, Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001), or by regulations issued by the Franchise Tax Board.

(iii) This subparagraph applies only to the extent that the provisions of the Internal Revenue Code or the regulation issued by "the secretary" authorizing an election for federal income tax purposes apply for purposes of this part, Part 10.2 (commencing with Section 18401) or Part 11 (commencing with Section 23001).

(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 17052.6 of the Revenue and Taxation Code is amended to read:

17052.6. (a) For each taxable year beginning on or after January 1, 2000, there shall be allowed as a credit against the "net tax" (as defined in Section 17039) an amount determined in accordance with Section 21 of the Internal Revenue Code, except that the amount of the credit shall be a percentage, as provided in subdivision (b) of the allowable federal credit without taking into account whether there is a federal tax liability.

(b) For the purposes of subdivision (a), the percentage of the allowable federal credit shall be determined as follows:

(1) For taxable years beginning before January 1, 2003:

If the adjusted gross income is:	The percentage of credit is:
$40,000 or less	63%
Over $40,000 but not over $70,000	53%
Over $70,000 but not over $100,000	42%
Over $100,000	0%

(2) For taxable years beginning on or after January 1, 2003:

If the adjusted gross income is:	The percentage of credit is:
$40,000 or less	50%
Over $40,000 but not over $70,000	43%
Over $70,000 but not over $100,000	34%
Over $100,000	0%

(c) In the case of a taxpayer whose credits provided under this section exceed the taxpayer's tax liability computed under this part, the excess shall be credited against other amounts due, if any, from the taxpayer and the balance, if any, shall be paid from the Tax Relief and Refund Account and refunded to the taxpayer.

(d) For purposes of this section, "adjusted gross income" means adjusted gross income as computed for purposes of paragraph (2) of subdivision (h) of Section 17024.5.

(e) The credit authorized by this section shall be limited, as follows:

(1) Employment-related expenses, within the meaning of Section 21 of the Internal Revenue Code, shall be limited to expenses for household services and care provided in this state.

(2) Earned income, within the meaning of Section 21(d) of the Internal Revenue Code, shall be limited to earned income subject to tax under this part. For purposes of this paragraph, compensation received by a member of the armed forces for active services as a member of the armed forces, other than pensions or retired pay, shall be considered earned income subject to tax under this part, whether or not the member is domiciled in this state.

(f) For purposes of this section, Section 21(b)(1) of the Internal Revenue Code, relating to a qualifying individual, is modified to additionally provide that a child (as defined in Section 151(c)(3) of the Internal Revenue Code) shall be treated, for purposes of Section 152 of the Internal Revenue Code (as applicable for purposes of this section), as receiving over one-half of his or her support during the calendar year from the parent having custody for a greater portion of the calendar year, that parent shall be treated as a "custodial parent" (within the meaning of Section 152(e) of the Internal Revenue Code, as applicable for purposes of this section), and the child shall be treated as a qualifying individual under Section 21(b)(1) of the Internal Revenue Code, as applicable for purposes of this section, if both of the following apply:

(1) The child receives over one-half of his or her support during the calendar year from his or her parents who never married each other and who live apart at all times during the last six months of the calendar year.

(2) The child is in the custody of one or both of his or her parents for more than one-half of the calendar year.

(g) The amendments to this section made by the act adding this subdivision shall apply only to taxable years beginning on or after January 1, 2002.

SEC. 3. Section 17053.62 is added to the Revenue and Taxation Code, to read:

17053.62. (a) For each taxable year beginning on or after July 1, 2005, and before January 1, 2018, there shall be allowed as an environmental tax credit against the "net tax," as defined by Section 17039, an amount equal to five cents ($0.05) for each gallon of ultra low sulfur diesel fuel produced during the taxable year by a small refiner at any facility located in this state.

(b) The aggregate credit determined under subdivision (a) for any taxable year with respect to any facility shall not exceed 25 percent of the qualified capital costs incurred by the small refiner with respect to that facility, reduced by the aggregate credits determined under this section for all prior taxable years with respect to that facility.

(c) For purposes of this section:

(1) "Small refiner" means any refiner who owns or operates a refinery in California that:

(A) Has and at all times had since January 1, 1978, a crude oil capacity of not more than 55,000 barrels per stream day.

(B) Has not been at any time since September 1, 1988, owned or controlled by any refiner that at the same time owned or controlled refineries in California with a total combined crude oil capacity of more than 55,000 barrels per stream day.

(C) Has not been at any time since September 1, 1988, owned or controlled by any refiner that at the same time owned or controlled refineries in the United States with a total combined crude oil capacity of more than 137,500 barrels per stream day.

(2) (A) "Qualified capital costs" means, with respect to any facility, those costs paid or incurred during the applicable period for items certified by the California Air Resources Board (CARB) under subparagraph (B) for compliance with the applicable EPA or CARB regulations with respect to that facility, including, but not limited to, expenditures for the construction of new process operation units or the dismantling and reconstruction of existing process units to be used in the production of ultra low sulfur diesel fuel, associated adjacent or offsite equipment (including tankage, catalyst, and power supply), engineering, construction period interest, site work, and permitting.

(B) (i) Before claiming a credit under this section, a small refiner shall request from the California Air Resources Board a certification that both of the following are true:

(I) That the items for which qualified capital costs were paid or incurred are for compliance with the applicable EPA or CARB regulations described in subparagraph (A).

(II) That the items for which qualified capital costs were paid or incurred have been placed in service by the small refiner.

(ii) The request described in clause (i) shall be in a form and contain sufficient information to allow the California Air Resources Board to determine that the items that are requested to be certified were placed in service for compliance with applicable EPA and CARB regulations, which information shall include the date on which the items were placed in service.

(C) The California Air Resources Board shall make a determination regarding a request described in subparagraph (B) on or before 60 days after the request is submitted. If the board does not make a determination within this time period, the certification will be deemed to be granted.

(D) If certification from the Secretary of the Treasury of the United States, after consultation with the Administrator of the Environmental Protection Agency, that the taxpayer's qualified capital costs with respect to a facility are, or will result, in compliance with applicable EPA regulations, has been received, then the taxpayer shall be allowed the credit without obtaining certification from the CARB, unless CARB demonstrates that the fuel produced does not meet CARB regulations.

(3) "Facility" means a small refiner's petroleum refinery located in the State of California that has incurred qualified capital costs to produce ultra low sulfur diesel fuel.

(4) "Applicable EPA regulations" means the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency.

(5) "Applicable CARB regulations" means the Vehicular Diesel Fuel Sulfur. Control Requirements of the California Air Resources Board (CARB) under Section 2281 of Article 2 of Chapter 5 of Division 3 of Title 13 of the California Code of Regulations.

(6) "Applicable period" means, with respect to any facility, the period beginning on January 1, 2004, and ending on May 31, 2007.

(7) "Ultra low sulfur diesel fuel" means both of the following:

(A) Diesel fuel with a sulfur content of 15 parts per million or less.

(B) (i) Subject to clause (ii), either of the following:

(I) Vehicular diesel fuel produced and sold by a small refiner on or after June 1, 2006.

(II) Vehicular diesel fuel produced and sold by the small refiner before June 1, 2006, that the small refiner specifically identifies and supports through internal test reports as meeting applicable CARB regulations.

(ii) For purposes of this section, it is rebuttably presumed that the fuel described in clause (i) is ultra low sulfur diesel fuel. The California Air Resources Board may rebut this presumption by demonstrating that the fuel does not comply with applicable CARB regulations.

(8) "Barrels per stream day" means the maximum number of barrels of input that a distillation facility can process within a 24-hour period when running at full capacity under optimal crude and product slate conditions with no allowance for downtime.

(d) For purposes of this section, if a credit is determined under this section for any expenditure with respect to any property, the increase in basis of that property that would (but for this subdivision) result from that expenditure shall be reduced by the amount of the credit so determined.

(e) No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction for the taxable year that is equal to the amount of the credit determined for the taxable year under this section.

(f) In the case where the credit allowed by this section exceeds the "net tax," the excess may be carried over to reduce the "net tax" in the following year, and the 10 succeeding years if necessary, until the credit is exhausted.

(g) If a small refiner that claims a credit under this section sells, transfers, or otherwise disposes of, either directly or indirectly, a facility within five years of the taxable year during which it first claimed the credit, there shall be added to the "net tax" of the small refiner during the taxable year of sale, transfer, or disposition an amount equal to the total credit claimed multiplied by a fraction, the numerator of which is the remaining term of five years and the denominator of which is 5.

(h) This section is repealed on January 1, 2018.

SEC. 4. Section 17072 of the Revenue and Taxation Code is amended to read:

17072. (a) Section 62 of the Internal Revenue Code, relating to adjusted gross income defined, shall apply, except as otherwise provided.

(b) Section 62(a)(2)(D) of the Internal Revenue Code, relating to certain expenses of elementary and secondary school teachers, shall not apply.

SEC. 5. Section 17077 of the Revenue and Taxation Code is amended to read:

17077. Section 68 of the Internal Revenue Code, relating to overall limitation on itemized deductions, shall apply, except as otherwise provided.

(a) "Six percent" shall be substituted for "3 percent" in Section 68(a)(1) of the Internal Revenue Code.

(b) Section 68(b)(1) of the Internal Revenue Code shall not apply and in lieu thereof the term "applicable amount" in each place it appears in Section 68(a) of the Internal Revenue Code means one hundred thousand dollars ($100,000) in the case of a single individual or a married individual filing a separate return, one hundred fifty thousand dollars ($150,000) in the case of a head of household, and two hundred thousand dollars ($200,000) in the case of a surviving spouse or a husband and wife filing a joint return.

(c) Section 68(b)(2) of the Internal Revenue Code, relating to inflation adjustments, shall not apply. However, for any taxable year beginning on or after January 1, 1992, the applicable amounts specified in subdivision (b) shall be recomputed annually in the same manner as the recomputation of income tax brackets under subdivision (h) of Section 17041.

(d) Section 68(f) of the Internal Revenue Code, relating to phaseout of limitation, shall not apply.

(e) Section 68(g) of the Internal Revenue Code, relating to termination, shall not apply.

SEC. 6. Section 17085 of the Revenue and Taxation Code is amended to read:

17085. Section 72 of the Internal Revenue Code, 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 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 employee trust or employee annuity that is includable in gross income for federal 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), 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 2 ½ 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 2 ½ 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. 7. Section 17131 of the Revenue and Taxation Code is amended to read:

17131. Part III of Subchapter B of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to items that are specifically excluded from gross income, shall apply, except as otherwise provided.

SEC. 7.5. Section 17131.4 is added to the Revenue and Taxation Code, to read:

17131.4. Section 106(d) of the Internal Revenue Code, relating to contributions to health savings accounts, shall not apply.

SEC. 7.6. Section 17131.5 is added to the Revenue and Taxation Code, to read:

17131.5. Section 125(d)(2)(D) of the Internal Revenue Code, relating to the exception for health savings accounts, shall not apply.

SEC. 8. Section 17131.6 is added to the Revenue and Taxation Code, to read:

17131.6. Section 107 of the Internal Revenue Code is modified by substituting in paragraph (2) the phrase "the rental allowance paid to him or her as part of his or her compensation, to the extent used by him or her to rent or provide a home" in lieu of the phrase "the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home and to the extent such allowance does not exceed the fair rental value of the home, including furnishings and appurtenances such as a garage, plus the cost of utilities" contained therein.

SEC. 9. Section 17131.8 of the Revenue and Taxation Code is repealed.

SEC. 10. Section 17132.5 of the Revenue and Taxation Code is amended to read:

17132.5. Section 101 of the Internal Revenue Code, relating to certain death benefits, is modified as follows:

(a) Section 101(h) of the Internal Revenue Code, relating to survivor benefits attributable to service by a public safety officer who is killed in the line of duty, is modified to apply to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after December 31, 1996.

(b) (1) Section 101 of the Internal Revenue Code, as modified by subdivision (a) is modified to additionally provide that Section 101(h) of the Internal Revenue Code shall not apply to survivor benefits attributable to service by a public safety officer who is killed in the line of duty with

respect to deaths occurring before December 31, 1996, that would otherwise be eligible for exclusion pursuant to Section 101(h) of the Internal Revenue Code, as modified by Public Law 107-15.

(2) The amendments made to this section by the act adding this subdivision shall apply to amounts paid after December 31, 2001, with respect to deaths occurring on or before December 31, 1996.

(c) (1) Section 101 of the Internal Revenue Code, as modified by subdivision (b), is modified to additionally provide that Section 101(i) of the Internal Revenue Code shall apply to any astronaut whose death occurs in the line of duty.

(2) The amendments made to this section by the act adding this subdivision shall apply to amounts received in taxable years beginning after December 31, 2002, with respect to deaths occurring after that date.

SEC. 10.5. Section 17136.5 of the Revenue and Taxation Code is repealed.

SEC. 11. Section 17137 of the Revenue and Taxation Code is repealed.

SEC. 12. Section 17139.6 is added to the Revenue and Taxation Code, to read:

17139.6. Section 139A of the Internal Revenue Code, relating to federal subsidies for prescription drug plans, shall not apply.

SEC. 13. 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) For taxable years beginning on or after January 1, 1998, and before January 1, 2002, 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) For taxable years beginning on or after January 1, 1998, and before January 1, 2002:

(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 (P.L. 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 (P.L. 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, relating to tax treatment of designated beneficiaries and contributors and to other definitions and special rules, respectively, shall apply, except as otherwise provided in Part 11 (commencing with Section 23001) and this part.

SEC. 14. Section 17140.3 of the Revenue and Taxation Code is amended to read:

17140.3. Section 529 of the Internal Revenue Code, 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. 15. 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 "33 ⅓ 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.

SEC. 16. Section 17144.5 of the Revenue and Taxation Code is repealed.

SEC. 17. Section 17152 of the Revenue and Taxation Code is amended to read:

17152. Section 121 of the Internal Revenue Code, relating to exclusion of gain from sale of principal residence, is modified as follows:

(a) The two-year period in Section 121(a) of the Internal Revenue Code shall be reduced by the period of the taxpayer's service, not to exceed 18 months, in the Peace Corps during the five-year period ending on the date of the sale or exchange.

(b) If the taxpayer is prohibited from filing a joint return pursuant to Section 18521, Section 121(b)(2)(A) of the Internal Revenue Code shall nevertheless be treated as being satisfied if the taxpayer files a joint return for federal income tax purposes for the same taxable year. However, in no

instance shall the total amount excludable from gross income under Section 121(a) of the Internal Revenue Code with respect to any sale or exchange exceed the maximum amount allowed by Section 121(b) of the Internal Revenue Code.

(c) (1) If a taxpayer has, at any time, made an election for federal purposes under Section 121(f) of the Internal Revenue Code not to have Section 121 of the Internal Revenue Code apply to a sale or exchange, Section 121 of the Internal Revenue Code shall not apply to that sale or exchange for state purposes, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, the federal election shall be binding for purposes of this part, and that election shall be treated as an election to include in gross income for purposes of this part all the gain from the sale or exchange of that property, including that amount which, but for that election, would have been excluded from income under Section 121(a) of the Internal Revenue Code for state purposes.

(2) If a taxpayer fails to make an election for federal purposes under Section 121(f) of the Internal Revenue Code to not have Section 121 of the Internal Revenue Code apply to a sale or exchange, no election under Section 121(f) of the Internal Revenue Code shall be allowed for state purposes, Section 121 of the Internal Revenue Code shall apply to that sale or exchange 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 312(d)(2) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to sales before date of enactment, or Section 312(d)(4) of that act, relating to binding contracts, to not have the amendments made by Section 312 of the Taxpayer Relief Act of 1997 (Public Law 105-34) apply to a sale or exchange, the amendments made by the act adding this subdivision shall not apply to that sale or exchange, Sections 1, 4, and 6 of Chapter 610 of the Statutes of 1997 shall not apply to that sale or exchange, 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 an election for federal purposes under Section 312(d)(2) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to sales before date of enactment, or Section 312(d)(4) of that act, relating to binding contracts, to not have the amendments made by Section 312 of the Taxpayer Relief Act of 1997 (Public Law 105-34) apply to a sale or exchange, an election under Section 312(d)(2) of the Taxpayer Relief Act of 1997 (Public Law 105-34), relating to sales before date of enactment, or Section 312(d)(4) of that act, relating to binding contracts, shall not be allowed for state purposes, the amendments made by the act adding this subdivision shall apply to that sale or exchange, Sections 1, 4, and 6 of Chapter 610 of the Statutes of 1997 shall apply to

that sale or exchange, 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 or revoked an election for federal purposes under Section 121(d)(9) of the Internal Revenue Code to suspend the running of the five-year period described in Sections 121(a), 121(c)(1)(B), and 121(d)(7) of the Internal Revenue Code, that election or revocation of election to suspend the five-year period under Section 121(d)(9) of the Internal Revenue Code shall be applicable for state purposes, a separate election or revocation of election for purposes of Section 121(d)(9) of the Internal Revenue Code may not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, and the federal election or revocation of election shall be binding for purposes of this part.

(2) If a taxpayer fails to make an election for federal purposes under Section 121(d)(9) of the Internal Revenue Code to suspend the running of the five-year period described in Sections 121(a), 121(c)(1)(B), and 121(d)(7) of the Internal Revenue Code, that five-year period may not be suspended under Section 121(d)(9) of the Internal Revenue Code for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

(f) Section 121(d)(10) of the Internal Revenue Code, relating to property acquired from a decedent, shall not apply.

SEC. 18. Section 17160.5 of the Revenue and Taxation Code is repealed.

SEC. 19. Section 17201.4 is added to the Revenue and Taxation Code, to read:

17201.4. Section 179B of the Internal Revenue Code, relating to deductions for capital costs incurred in complying with Environmental Protection Agency sulfur regulations, shall not apply.

SEC. 20. Section 17201.5 is added to the Revenue and Taxation Code, to read:

17201.5. Section 181 of the Internal Revenue Code, relating to treatment of certain qualified film and television productions, shall not apply.

SEC. 21. Section 17201.6 is added to the Revenue and Taxation Code, to read:

17201.6. Section 199 of the Internal Revenue Code, relating to income attributable to domestic production activities, shall not apply.

SEC. 22. Section 17202.5 of the Revenue and Taxation Code is repealed.

SEC. 23. Section 17204 of the Revenue and Taxation Code is amended to read:

17204. (a) Section 221 of the Internal Revenue Code, relating to interest on education loans, is modified to additionally provide that a deduction shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 60 months, whether or not consecutive, in which interest payments are required. For purposes of this subdivision, any loan and period shall be determined in the form and

manner prescribed in forms and instructions by the Franchise Tax Board in the case of multiple loans that are refinanced by, or serviced as, a single loan and in the case of loans incurred before January 1, 2005.

(b) (1) Section 221(b)(2)(B)(i)(I) of the Internal Revenue Code is modified by substituting the phrase "$40,000 ($60,000 in the case of a joint return)" in lieu of the phrase "$50,000 ($100,000 in the case of a joint return)" contained therein.

(2) Section 221(b)(2)(B)(ii) of the Internal Revenue Code is modified by substituting the phrase "$15,000" in lieu of the phrase "$15,000 ($30,000 in the case of a joint return)" contained therein.

(3) Section 221(f)(1) of the Internal Revenue Code is modified by substituting the phrase "$40,000 and $60,000 amounts" in lieu of the phrase "$50,000 and $100,000 amounts" contained therein.

(c) This section shall apply to taxable years beginning on and after January 1, 2005, and before January 1, 2006. This section shall remain in effect only until January 1, 2006, and as of that date is repealed.

SEC. 24. Section 17204.7 is added to the Revenue and Taxation Code, to read:

17204.7. Section 222 of the Internal Revenue Code, relating to qualified tuition and related expenses, shall not apply.

SEC. 25. Section 17205 of the Revenue and Taxation Code, as added by Section 14 of Chapter 34 of the Statutes of 2002, is repealed.

SEC. 26. Section 17205 of the Revenue and Taxation Code, as added by Section 14 of Chapter 35 of the Statutes of 2002, is repealed.

SEC. 26.5. Section 17215.1 is added to the Revenue and Taxation Code, to read:

17215.1. Section 220(f)(5) of the Internal Revenue Code, relating to rollover contributions, shall not apply.

SEC. 26.6. Section 17215.4 is added to the Revenue and Taxation Code, to read:

17215.4. Section 223 of the Internal Revenue Code, relating to health savings accounts, shall not apply.

SEC. 27. Section 17220 of the Revenue and Taxation Code is amended to read:

17220. (a) Section 164(a)(3) of the Internal Revenue Code, relating to the deductibility of state, local, and foreign income, war profits, and excess profits taxes, shall not apply.

(b) Section 164(b)(5) of the Internal Revenue Code, relating to general sales taxes, shall not apply.

(c) In addition to the provisions of Section 164(c) of the Internal Revenue Code, relating to deduction denied in case of certain taxes, no deduction shall be allowed for any tax imposed under Chapter 10.5 (commencing with Section 17935), Chapter 10.6 (commencing with Section 17941), or Chapter 10.7 (commencing with Section 17951) of this part or under Part 11 (commencing with Section 23001).

SEC. 28. Section 17250 of the Revenue and Taxation Code is amended to read:

17250. (a) Section 168 of the Internal Revenue Code is modified as follows:

(1) Any reference to "tax imposed by this chapter" in Section 168 of the Internal Revenue Code means "net tax," as defined in Section 17039.

(2) (A) Section 168(e)(3) is modified to provide that any grapevine, replaced in a vineyard in California in any taxable year beginning on or after January 1, 1992, as a direct result of a phylloxera infestation in that vineyard, or replaced in a vineyard in California in any taxable year beginning on or after January 1, 1997, as a direct result of Pierce's disease in that vineyard, shall be "five-year property," rather than "10-year property."

(B) Section 168(g)(3) of the Internal Revenue Code is modified to provide that any grapevine, replaced in a vineyard in California in any taxable year beginning on or after January 1, 1992, as a direct result of a phylloxera infestation in that vineyard, or replaced in a vineyard in California in any taxable year beginning on or after January 1, 1997, as a direct result of Pierce's disease in that vineyard, shall have a class life of 10 years.

(C) Every taxpayer claiming a depreciation deduction with respect to grapevines as described in this paragraph shall obtain a written certification from an independent state-certified integrated pest management adviser, or a state agricultural commissioner or adviser, that specifies that the replanting was necessary to restore a vineyard infested with phylloxera or Pierce's disease. The taxpayer shall retain the certification for future audit purposes.

(3) Section 168(j) of the Internal Revenue Code, relating to property on Indian reservations, shall not apply.

(4) Section 168(k) of the Internal Revenue Code, relating to special allowance for certain property acquired after September 10, 2001, and before January 1, 2005, shall not apply.

(5) Sections 168(b)(3)(G) and 168(b)(3)(H) of the Internal Revenue Code, relating to property to which the straight line method applies, shall not apply.

(6) Sections 168(e)(3)(E)(iv) and 168(e)(3)(E)(v) of the Internal Revenue Code, relating to 15-year property, shall not apply.

(7) Sections 168(e)(6) and 168(e)(7) of the Internal Revenue Code, relating to qualified leasehold improvement property and to qualified restaurant property, respectively, shall not apply.

(b) Section 169 of the Internal Revenue Code, relating to amortization of pollution control facilities, is modified as follows:

(1) The deduction allowed by Section 169 of the Internal Revenue Code shall be allowed only with respect to facilities located in this state.

(2) The "state certifying authority," as defined in Section 169(d)(2) of the Internal Revenue Code, means the State Air Resources Board, in the case of air pollution, and the State Water Resources Control Board, in the case of water pollution.

SEC. 29. Section 17250.5 of the Revenue and Taxation Code is amended to read:

17250.5. Section 167(g) of the Internal Revenue Code, relating to depreciation under income forecast method, shall be modified as follows:

(a) Section 167(g)(2)(C) of the Internal Revenue Code is modified by substituting "Section 19521" in lieu of "Section 460(b)(7)" of the Internal Revenue Code.

(b) Section 167(g)(5)(D) of the Internal Revenue Code is modified by substituting "Part 10.2 (commencing with Section 18401) (other than Section 19136)" in lieu of "Subtitle F (other than Sections 6654 and 6655)."

(c) Section 167(g)(5)(E) of the Internal Revenue Code, relating to treatment of distribution costs, shall not apply.

(d) Section 167(g)(7) of the Internal Revenue Code, relating to treatment of participations and residuals, shall not apply.

SEC. 30. Section 17255 of the Revenue and Taxation Code is amended to read:

17255. (a) Section 179(b)(1) of the Internal Revenue Code, relating to dollar limitation, shall not apply and in lieu thereof, the aggregate cost which may be taken into account under Section 179(a) of the Internal Revenue Code for any taxable year shall not exceed twenty-five thousand dollars ($25,000).

(b) Section 179(b)(2) of the Internal Revenue Code, relating to reduction in limitation, shall not apply and in lieu thereof, the limitation under subdivision (a) for any taxable year shall be reduced, but not to below zero, by the amount by which the cost of Section 179 property, as defined in Section 179(d)(1) of the Internal Revenue Code, except as otherwise provided, placed in service during the taxable year exceeds two hundred thousand dollars ($200,000).

(c) Section 179 of the Internal Revenue Code is modified to provide that the "aggregate amount disallowed" referred to in Section 179(b)(3)(B) of the Internal Revenue Code shall be computed under this part as it read on the date the property generating the amount disallowed was placed in service.

(d) Section 179(b)(5) of the Internal Revenue Code, relating to inflation adjustments, shall not apply.

(e) The last sentence in Section 179(c)(2) of the Internal Revenue Code, relating to election irrevocable, shall not apply.

(f) Section 179(d)(1)(A)(ii) of the Internal Revenue Code, relating to computer software, shall not apply.

SEC. 31. Section 17255.5 is added to the Revenue and Taxation Code, to read:

17255.5. (a) For any taxable year which includes part of the "applicable period" as defined in paragraph (6) of subdivision (c) of Section 17053.62, a small refiner (as defined in Section 17053.62) may elect to treat 75 percent of qualified capital costs (as defined in paragraph (2) of subdivision (c) of Section 17053.62) paid or incurred by the

taxpayer during the taxable year as expenses that are not chargeable to capital account. Any cost so treated shall be allowed as a deduction for the taxable year in which paid or incurred.

(b) (1) For purposes of this part, the basis of any property shall be reduced by the portion of the cost of that property taken into account under subdivision (a).

(2) For purposes of Section 1245 of the Internal Revenue Code, and corresponding section of this part, the amount of the deduction allowable under subdivision (a) with respect to any property which is of a character subject to the allowance for depreciation shall be treated as a deduction allowed for depreciation under Section 167 of the Internal Revenue Code, or the corresponding section of this part.

(c) This section shall remain in effect only until January 1, 2009, and as of that date is repealed.

SEC. 32. Section 17256 of the Revenue and Taxation Code is amended to read:

17256. Section 179A of the Internal Revenue Code, relating to deduction for clean-fuel vehicles and certain refueling property, shall not apply.

SEC. 33. Section 17279.4 of the Revenue and Taxation Code is amended to read:

17279.4. Section 198 of the Internal Revenue Code, relating to expensing of environmental remediation costs, is modified as follows:

(a) For expenditures paid or incurred before January 1, 2004, all of the following shall apply:

(1) If a taxpayer has, at any time, made an election for federal purposes under Section 198(a) of the Internal Revenue Code to have Section 198 of the Internal Revenue Code apply to a qualified environmental remediation expenditure, Section 198 of the Internal Revenue Code shall apply to that qualified environmental remediation expenditure 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 an election for federal purposes under Section 198(a) of the Internal Revenue Code to have Section 198 of the Internal Revenue Code apply to a qualified environmental remediation expenditure, an election under Section 198(a) of the Internal Revenue Code shall not be allowed for state purposes, Section 198 of the Internal Revenue Code shall not apply to that qualified environmental remediation expenditure for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

(b) No inference as to the proper treatment for purposes of this part of qualified environmental remediation expenditures paid or incurred in taxable years beginning before January 1, 1998, shall be made.

(c) Section 198(h) of the Internal Revenue Code, relating to termination, shall not apply.

(d) Section 198 of the Internal Revenue Code, relating to expensing of environmental remediation costs, shall not apply to expenditures paid or incurred after December 31, 2003.

SEC. 34. 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 the specified date contained in paragraph (1) of subdivision (a) of Section 17024.5, Part I of Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to pension, profitsharing, stock bonus plans, etc., shall apply, except as otherwise provided, without regard to taxable year to the same extent as applicable for federal income tax 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 402(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 as amended by 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. 35. 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 the specified date contained in paragraph (1) of subdivision (a) of 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 income tax 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, as applicable for state purposes, 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 as amended by 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 provisions of the plan or by operation of law.

(f) Section 451(i) of the Internal Revenue Code, relating to special rule for sales or dispositions to implement Federal Energy Regulatory Commission or state electric restructuring policy, shall not apply.

SEC. 36. Section 17681.6 is added to the Revenue and Taxation Code, to read:

17681.6. Section 613A(c)(6)(H) of the Internal Revenue Code, relating to temporary suspension of taxable income limit with respect to marginal production, shall not apply.

SEC. 37. Section 17731 of the Revenue and Taxation Code is amended to read:

17731. (a) Subchapter J of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to estates, trusts, beneficiaries, and decedents, shall apply, except as otherwise provided.

(b) Section 692(d)(2) of the Internal Revenue Code, relating to the ten thousand-dollar ($10,000) minimum benefit, does not apply.

SEC. 37.5. Section 17733 of the Revenue and Taxation Code is amended to read:

17733. (a) An estate shall be allowed a credit of ten dollars ($10) against the tax imposed under Section 17041, less any amounts imposed under paragraph (1) of subdivision (d) or paragraph (1) of subdivision (e), or both, of Section 17560.

(b) (1) Except as provided in paragraph (2), a trust shall be allowed a credit of one dollar ($1) against the tax imposed under Section 17041, less any amounts imposed under paragraph (1) of subdivision (d) or paragraph (1) of subdivision (e), or both, of Section 17560.

(2) (A) A disability trust, as defined in Section 642(b)(2)(C) of the Internal Revenue Code, shall be allowed a credit in an amount equal to the personal exemption credit authorized for a single individual pursuant to subdivision (a) of Section 17054.

(B) The credit authorized by subparagraph (A) shall be subject to the credit reduction provisions of Section 17054.1. For purposes of making the adjustments required by Section 17054.1, the adjusted gross income of the disability trust shall be computed in accordance with Section 67(e) of the Internal Revenue Code, relating to determination of adjusted gross income in case of estates and trusts.

(C) This paragraph applies to taxable years beginning on or after January 1, 2004.

(c) The credits allowed by this section shall be in lieu of the credits allowed under Section 17054 (relating to credit for personal exemption).

SEC. 37.6. Section 17734.6 is added to the Revenue and Taxation Code, to read:

17734.6. Section 646 of the Internal Revenue Code, relating to tax treatment of electing Alaska Native Settlement Trusts, shall not apply.

SEC. 38. Section 17760 is added to the Revenue and Taxation Code, to read:

17760. Section 684 of the Internal Revenue Code, relating to recognition of gain on certain transfers to certain foreign trusts and estates, shall not apply.

SEC. 39. Section 18035.6 is added to the Revenue and Taxation Code, to read:

18035.6. Section 1014 of the Internal Revenue Code, relating to basis of property acquired from a decedent, is modified to provide that Section 1014(f) of the Internal Revenue Code, relating to termination date, shall not apply.

SEC. 40. Section 18036.6 is added to the Revenue and Taxation Code, to read:

18036.6. Section 1022 of the Internal Revenue Code, relating to treatment of property acquired from a decedent dying after December 31, 2009, shall not apply.

SEC. 40.5. Section 18181 is added to the Revenue and Taxation Code, to read:

18181. Part VI of Subchapter P of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to treatment of certain passive foreign investment companies, shall not apply.

SEC. 41. Section 18571 of the Revenue and Taxation Code is amended to read:

18571. (a) The provisions of Section 7508 of the Internal Revenue Code, relating to time for performing certain acts postponed by reason of service in a combat zone or contingency operation, shall apply except as otherwise provided.

(b) Section 7508(e)(1) of the Internal Revenue Code, relating to tax in jeopardy, etc., is modified to refer to jeopardy assessments and liens authorized under this part, in lieu of the references to Section 6851 and Chapter 70 or 71 of the Internal Revenue Code.

(c) Notwithstanding Section 17034, this section shall be operative without regard to taxable years and shall be operative with respect to any actions specified in Section 18570 that are required or permitted to be taken on or after August 2, 1990.

SEC. 42. Section 18572 of the Revenue and Taxation Code is amended to read:

18572. Section 7508A of the Internal Revenue Code, relating to postponement of certain tax-related deadlines, shall apply, except as otherwise provided.

SEC. 42.5. Section 18628 of the Revenue and Taxation Code is amended to read:

18628. (a) Section 6111 of the Internal Revenue Code, relating to disclosure of reportable transactions, applies, except as otherwise provided.

(b) (1) Except as provided in subdivision (e), a material advisor is required to send a duplicate of the federal return, if applicable, or the same information required to be provided on the federal reportable transactions return for California reportable transactions to the Franchise Tax Board not later than the date specified by the Franchise Tax Board or the Secretary of the Treasury.

(2) (A) The information provided to the Franchise Tax Board pursuant to paragraph (1) shall also include any other information required by a Franchise Tax Board Notice.

(B) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any additional information requested under this section.

(c) Section 6111 of the Internal Revenue Code is modified by substituting the phrase “Secretary or the Franchise Tax Board” for the word “Secretary” in each place it appears.

(d) The reportable transactions return requirements of this section shall apply to any material advisor with respect to any reportable transaction, as defined in Section 6707A(c) of the Internal Revenue Code with respect to a material advisor that satisfies any of the following conditions:

(1) Is organized in this state.

(2) Is doing business in this state.

(3) Derives income from sources in this state.

(4) Provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction with respect to a taxpayer that meets any of the following requirements:

(A) Is organized in this state.

(B) Does business in this state.

(C) Derives income from sources in this state.

(e) In addition to the requirements set forth in subdivision (a), for any transactions entered into on or after February 28, 2000, that become listed transactions (as defined under Section 6707A(c)(2) of the Internal Revenue Code) at any time, a return for those transactions shall be required to be filed with the Franchise Tax Board by the later of:

(1) Sixty days after entering into the transaction.

(2) Sixty days after the transaction becomes a listed transaction.

(3) Sixty days after the effective date of the act amending this section.

(f) In addition to the requirements set forth in subdivisions (a) and (e), for any transactions entered into on or after September 2, 2003, that are specifically identified by the Franchise Tax Board for California income or franchise tax purposes (under the authority of paragraph (4) of subdivision (a) of Section 18407) as a "listed transaction" at any time, a return for those transactions shall be required to be filed with the Franchise Tax Board by the later of:

(1) Sixty days after entering into the transaction.

(2) Sixty days after the transaction becomes a listed transaction.

(3) Sixty days after the effective date of the act amending this section.

SEC. 43. Section 18633 of the Revenue and Taxation Code is amended to read:

18633. (a) (1) Every partnership, on or before the 15th day of the fourth month following the close of its taxable year, shall make a return for that taxable year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001). Except as otherwise provided in Section 18621.5, the return shall include the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each person. The return shall contain or be verified by a written declaration that it is made under penalty of perjury, signed by one of the partners.

(2) In addition to returns required by paragraph (1), every limited partnership subject to the tax imposed by subdivision (b) of Section 17935, on or before the 15th day of the fourth month following the close of its taxable year, shall make a return for that taxable year, containing the information identified in paragraph (1). In the case of a limited partnership not doing business in this state, the Franchise Tax Board shall prescribe the manner and extent to which the information identified in paragraph (1) shall be included with the return required by this paragraph.

(b) Each partnership required to file a return under subdivision (a) for any taxable year shall (on or before the day on which the return for that

taxable year was required to be filed) furnish to each person who is a partner or who holds an interest in that partnership as a nominee for another person at any time during that taxable year a copy of the information required to be shown on that return as may be required by regulations.

(c) Any person who holds an interest in a partnership as a nominee for another person shall do both of the following:

(1) Furnish to the partnership, in the manner prescribed by the Franchise Tax Board, the name, address, and taxpayer identification number of that other person, and any other information for that taxable year as the Franchise Tax Board may by form and regulation prescribe.

(2) Furnish to that other person, in the manner prescribed by the Franchise Tax Board, the information provided by that partnership under subdivision (b).

(d) The provisions of Section 6031(d) of the Internal Revenue Code, relating to the separate statement of items of unrelated business taxable income, shall apply.

(e) The provisions of Section 6031(f) of the Internal Revenue Code, relating to electing investment partnerships, shall apply, except as otherwise provided.

SEC. 43.5. Section 18648 of the Revenue and Taxation Code is amended to read:

18648. (a) Section 6112 of the Internal Revenue Code, relating to material advisors of reportable transactions that must keep lists of advisees, applies except as otherwise provided.

(b) Section 6112 of the Internal Revenue Code is modified by substituting the phrase "Secretary or the Franchise Tax Board" for the word "Secretary" each place it appears.

(c) The requirement to maintain lists under this section shall apply to any material advisor, as defined in Section 6111 of the Internal Revenue Code, with respect to any reportable transaction, as defined in Section 6707A(c) of the Internal Revenue Code and regardless of whether a return is required to be filed under Section 18628 with respect to that reportable transaction and with respect to a material advisor that satisfies any of the following conditions:

(1) Is organized in this state.

(2) Is doing business in this state.

(3) Derives income from sources in this state.

(4) Provides any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction with respect to a taxpayer that meets any of the following conditions:

(A) Is organized in this state.

(B) Does business in this state.

(C) Derives income from sources in this state.

(d) (1) In addition to any regulation issued under Section 6112 of the Internal Revenue Code, the list required to be maintained by this section

for listed transactions, as defined in Section 6707A(c)(2) of the Internal Revenue Code, shall be maintained in the form and manner prescribed by the Franchise Tax Board.

(2) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any requirement prescribed by the Franchise Tax Board under this section.

(3) For transactions entered into on or after February 28, 2000, that become listed transactions (as defined under Section 6707A(c)(2) of the Internal Revenue Code) at any time, the lists shall be provided to the Franchise Tax Board by the later of:

(A) Sixty days after entering into the transaction.

(B) Sixty days after the transaction becomes a listed transaction.

(4) For transactions entered into on or after September 2, 2003, that are specifically identified by the Franchise Tax Board for California income or franchise tax purposes (under the authority of paragraph (4) of subdivision (a) of Section 18407) as a "listed transaction" at any time, the list shall be provided to the Franchise Tax Board by the later of:

(A) Sixty days after entering into the transaction.

(B) Sixty days after the transaction becomes a listed transaction.

SEC. 44. Section 19008 of the Revenue and Taxation Code is amended to read:

19008. (a) The Franchise Tax Board may, in cases of financial hardship, as determined by the Franchise Tax Board, allow an individual or fiduciary to enter into installment payment agreements with the Franchise Tax Board to make payments on taxes due, plus applicable interest and penalties over the life of the installment period. Failure by an individual or fiduciary to comply fully with the terms of the installment payment agreement shall render the agreement null and void, unless the Franchise Tax Board determines that the failure was due to a reasonable cause, and the total amount of tax, interest, and all penalties shall be immediately due and payable.

(b) In the case of a liability for tax of an individual under Part 10 (commencing with Section 17001) or this part, the Franchise Tax Board shall enter into an agreement to accept the full payment of the tax in installments if, as of the date the individual offers to enter into the agreement, all of the following apply:

(1) The aggregate amount of the liability (determined without regard to interest, penalties, additions to the tax and additional amounts) does not exceed ten thousand dollars ($10,000).

(2) The taxpayer (and, if the liability relates to a joint return, the taxpayer's spouse) has not during any of the preceding five taxable years done any of the following:

(A) Failed to file any return of tax imposed under Part 10 (commencing with Section 17001) or this part.

(B) Failed to pay any tax required to be shown on the return.

(C) Entered into an installment agreement under this section for payment of any tax imposed by Part 10 (commencing with Section 17001) or this part.

(3) The Franchise Tax Board determines that the taxpayer is financially unable to pay the liability in full when due (and the taxpayer submits any information as the Franchise Tax Board may require to make this determination).

(4) The agreement requires full payment of the liability within three years.

(5) The taxpayer agrees to comply with the provisions of this part and Part 10 (commencing with Section 17001) for the period the agreement is in effect.

(c) Except in any case where the Franchise Tax Board finds collection of the tax to which an installment payment agreement relates to be in jeopardy, or there is a mutual consent to terminate, alter, or modify the agreement, the agreement shall not be considered null and void, or otherwise terminated, unless both of the following occur:

(1) A notice of termination is provided to the individual or fiduciary not later than 30 days before the date of termination.

(2) The notice includes an explanation of why the Franchise Tax Board intends to terminate the agreement.

(d) No levy may be issued on the property or rights to property of any person with respect to any unpaid tax:

(1) During the period that an offer by the taxpayer for an installment agreement under this section for payment of the unpaid tax is pending with the Franchise Tax Board.

(2) If the offer is rejected by the Franchise Tax Board, during the 30 days thereafter (and, if a request for review of the rejection is filed within the 30 days, during the period that the review is pending).

(3) During the period that the installment agreement for payment of the unpaid tax is in effect.

(4) If the agreement is terminated by the Franchise Tax Board, during the 30 days thereafter (and, if a request for review of the termination is filed within the 30 days, during the period that the review is pending).

(5) This subdivision shall not apply with respect to any of the following:

(A) Any unpaid tax if either of the following occurs:

(i) The taxpayer files a written notice with the Franchise Tax Board that waives the restriction imposed by this subdivision on levy with respect to the tax.

(ii) The Franchise Tax Board finds that the collection of that tax is in jeopardy.

(B) Any levy that was first issued before the date that the applicable proceeding under this subdivision commenced.

(C) At the discretion of the Franchise Tax Board, any unpaid tax for which the taxpayer makes an offer of an installment agreement subsequent

to a rejection of an offer of an installment agreement with respect to that unpaid tax (or to any review thereof).

(D) The period of limitation under Section 19371 shall be suspended for the period during which the Franchise Tax Board is prohibited under this subdivision from making a levy.

(e) The Taxpayers' Rights Advocate shall establish procedures for an independent departmental administrative review for the rejection of the offer of an installment payment and for installment payment agreements that are rendered null and void, or otherwise terminated under this section, for individuals or fiduciaries who request that review. This administrative review shall not be subject to Chapter 4.5 (commencing with Section 11400) of Part 1 of Division 3 of the Government Code. Unless review is requested by the taxpayer within 30 days of the date of rejection of the offer of an installment agreement or termination of the installment agreement, this administrative review shall not stay collection of the tax to which the installment payment agreement relates.

(f) In the case of an agreement for partial payment of a tax liability entered into by the Franchise Tax Board pursuant to subdivision (a), the Franchise Tax Board shall review the agreement at least once every two years.

(g) The amendments made by the act adding this subdivision are operative for any proposed installment agreement submitted after the effective date of that act.

SEC. 45. Section 19041.5 of the Revenue and Taxation Code is amended to read:

19041.5. (a) Notwithstanding any other provision of this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001), the provisions of Section 6603 of the Internal Revenue Code, relating to deposits made to suspend the running of interest on potential underpayments, shall apply, except as otherwise provided. A deposit shall not be considered a payment of tax for purposes of filing a claim for refund pursuant to Section 19306, converting an administrative action to an action on a claim pursuant to Section 19335, or filing an action pursuant to Section 19384, until either of the following occurs:

(1) The taxpayer provides a written statement to the Franchise Tax Board specifying that the deposit shall be a payment of tax for purposes of Section 19306, 19335, or 19384.

(2) The deposit is used to pay a final tax liability.

(b) Section 6603(d) of the Internal Revenue Code is modified to substitute the phrase "notice of proposed deficiency assessment under Article 3 of Chapter 4 of this part" for "30-day letter" in each place that the phrase "30-day letter" appears.

(c) In the case of any amount held by the Franchise Tax Board as a deposit in the nature of a cash bond pursuant to the provisions of this section prior to the amendments made by the act adding this subdivision, the date that the taxpayer identifies that amount as a deposit made pursuant to this section, as amended by the act adding this subdivision, shall be

treated as the date that the amount is deposited for purposes of this section, as amended by the act adding this subdivision.

SEC. 46. Section 19116 of the Revenue and Taxation Code is amended to read:

19116. (a) In the case of an individual who files a return of tax imposed under Part 10 (commencing with Section 17001) for a taxable year on or before the due date for the return, including extensions, if the Franchise Tax Board does not provide a notice to the taxpayer specifically stating the taxpayer's liability and the basis of the liability before the close of the notification period, the Franchise Tax Board shall suspend the imposition of any interest, penalty, addition to tax, or additional amount with respect to any failure relating to the return which is computed by reference to the period of time the failure continues to exist and which is properly allocable to the suspension period.

(b) For purposes of this section:

(1) Except as provided in subdivision (e), "notification period" means the 18-month period beginning on the later of either of the following:

(A) The date on which the return is filed.

(B) The due date of the return without regard to extensions.

(2) "Suspension period" means the period beginning on the day after the close of the notification period and ending on the date which is 15 days after the date on which notice described in subdivision (a) is provided by the Franchise Tax Board.

(c) This section shall be applied separately with respect to each item or adjustment.

(d) This section shall not apply to any of the following:

(1) Any penalty imposed by Section 19131.

(2) Any penalty imposed by Section 19132.

(3) Any interest, penalty, addition to tax, or additional amount involving fraud.

(4) Any interest, penalty, addition to tax, or additional amount with respect to any tax liability shown on the return.

(5) Any criminal penalty.

(6) Any interest, penalty, addition to tax, or additional amount with respect to any gross misstatement.

(7) Any interest, penalty, addition to tax, or additional amount relating to any reportable transaction with respect to which the requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, and any listed transaction, as defined in Section 6707A(c) of the Internal Revenue Code.

(e) For taxpayers required by subdivision (a) of Section 18622 to report a change or correction by the Commissioner of Internal Revenue or other officer of the United States or other competent authority the following rules shall apply:

(1) The notification period under subdivision (a) shall be either of the following:

(A) One year from the date the notice required by Section 18622 is filed with the Franchise Tax Board by the taxpayer or the Internal Revenue Service, if the taxpayer or the Internal Revenue Service reports that change or correction within six months after the final federal determination.

(B) Two years from the date when the notice required by Section 18622 is filed with the Franchise Tax Board by the taxpayer or the Internal Revenue Service, if after the six-month period required in Section 18622, a taxpayer or the Internal Revenue Service reports a change or correction.

(2) The suspension period under subdivision (a) shall mean the period beginning on the day after the close of the notification period under paragraph (1) and ending on the date which is 15 days after the date on which notice described in subdivision (a) is provided by the Franchise Tax Board.

(f) For notices sent after January 1, 2004, this section does not apply to taxpayers with taxable income greater than two hundred thousand dollars ($200,000) that have been contacted by the Franchise Tax Board regarding the use of a potentially abusive tax shelter (within the meaning of Section 19777).

(g) This section shall apply to taxable years ending after October 10, 1999.

(h) The amendments made to this section by the act adding this subdivision shall apply to notices sent after January 1, 2005.

SEC. 47. Section 19136.12 is added to the Revenue and Taxation Code, to read:

19136.12. (a) No addition to tax shall be made pursuant to Section 19136 for any period before the date prescribed under Section 18566 for the filing of the return for the 2005 taxable year, with respect to any underpayment of an installment for the 2005 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 pursuant to Section 18601 for the filing of the return for the 2005 taxable year, with respect to any underpayment of an installment for the 2005 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. 47.1. Section 19164 of the Revenue and Taxation Code is amended to read:

19164. (a) (1) (A) An accuracy-related penalty shall be imposed under this part and shall be determined in accordance with Section 6662 of the Internal Revenue Code, relating to imposition of accuracy-related penalty on underpayments, except as otherwise provided.

(B) (i) Except for understatements relating to reportable transactions to which Section 19164.5 applies, in the case of any proposed deficiency assessment issued after the last date of the amnesty period specified in Chapter 9.1 (commencing with Section 19730) for any taxable year

beginning prior to January 1, 2003, the penalty specified in Section 6662(a) of the Internal Revenue Code shall be computed by substituting "40 percent" for "20 percent."

(ii) Clause (i) shall not apply to any taxable year of a taxpayer beginning prior to January 1, 2003, if, as of the start date of the amnesty program period specified in Section 19731, the taxpayer is then under audit by the Franchise Tax Board, or the taxpayer has filed a protest under Section 19041, or the taxpayer has filed an appeal under Section 19045, or the taxpayer is engaged in settlement negotiations under Section 19442, or the taxpayer has a pending judicial proceeding in any court of this state or in any federal court relating to the tax liability of the taxpayer for that taxable year.

(2) With respect to corporations, this subdivision shall apply to all of the following:

(A) All taxable years beginning on or after January 1, 1990.

(B) Any other taxable year for which an assessment is made after July 16, 1991.

(C) For purposes of this section, references in Section 6662(e) of the Internal Revenue Code and the regulations thereunder, relating to treatment of an affiliated group that files a consolidated federal return, are modified to apply to those entities required to be included in a combined report under Section 25101 or 25110. For these purposes, entities included in a combined report pursuant to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be considered only to the extent required to be included in the combined report.

(3) Section 6662(d)(1)(B) of the Internal Revenue Code is modified to provide that in the case of a corporation, other than an "S" corporation, there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of:

(A) Ten percent of the tax required to be shown on the return for the taxable year (or, if greater, two thousand five hundred dollars ($2,500)).

(B) Five million dollars ($5,000,000).

(4) Section 6662(d)(2)(A) of the Internal Revenue Code is modified to additionally provide that the excess determined under Section 6662(d)(2)(A) of the Internal Revenue Code shall be determined without regard to items to which Section 19164.5 applies and without regard to items with respect to which a penalty is imposed by Section 19774.

(b) For purposes of Section 6662(d) of the Internal Revenue Code, Section 6664 of the Internal Revenue Code, Section 6694(a)(1) of the Internal Revenue Code, and this part, the Franchise Tax Board may prescribe a list of positions for which the Franchise Tax Board believes there is not substantial authority or there is no reasonable belief that the tax treatment is more likely than not the proper tax treatment. That list (and any revisions thereof) shall be published through the use of Franchise Tax Board Notices or other published positions. In addition, the "listed transactions" identified and published pursuant to the preceding sentence shall be published on the Web site of the Franchise Tax Board.

(c) A fraud penalty shall be imposed under this part and shall be determined in accordance with Section 6663 of the Internal Revenue Code, relating to imposition of fraud penalty, except as otherwise provided.

(d) Section 6664 of the Internal Revenue Code, relating to definitions and special rules, shall apply, except as otherwise provided.

SEC. 47.2. Section 19164.5 is added to the Revenue and Taxation Code, to read:

19164.5. (a) A reportable transaction accuracy-related penalty shall be imposed under this part and shall be determined in accordance with Section 6662A of the Internal Revenue Code, relating to the imposition of an accuracy-related penalty on understatements with respect to reportable transactions, except as otherwise provided.

(b) (1) The reportable transaction understatement, as determined under Section 6662A(b) of the Internal Revenue Code, is modified to not include amounts to which the penalty of Section 19774 is imposed.

(2) Section 6662A(b)(1)(A)(ii) of the Internal Revenue Code is modified to substitute the phrase "Sections 17041, 23151, 23181, or 23501" for "section 1 (section 11 in the case of a taxpayer which is a corporation)."

(3) Section 6662A(b)(1)(B) of the Internal Revenue Code is modified to substitute the phrase "Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001)" for "subtitle A."

(4) Section 6662A(b)(2)(B) of the Internal Revenue Code is modified to substitute the phrase "income or franchise tax" for "Federal income tax."

(5) Section 6662A(e)(1) of the Internal Revenue Code is modified to additionally provide that the amount of the understatement is increased by noneconomic transaction understatements, as defined in Section 19774.

(c) Section 6662A(e)(2) of the Internal Revenue Code is modified to additionally provide that Section 6662A of the Internal Revenue Code does not apply to amounts to which a penalty is imposed under Section 19774.

(d) The provisions of subdivision (f) of Section 19772, relating to the rescission of the penalty by the Chief Counsel, shall apply to any penalty imposed by this section.

SEC. 47.3. Section 19166 of the Revenue and Taxation Code is amended to read:

19166. (a) A penalty shall be imposed for understatement of any taxpayer's liability by a tax return preparer and shall be determined in accordance with Section 6694 of the Internal Revenue Code, except as otherwise provided.

(b) (1) For taxpayers that have a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code, with respect to which the requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code, Section 6694(a) of

the Internal Revenue Code is modified to substitute "one thousand dollars ($1,000)" for "two hundred fifty dollars ($250)."

(2) Section 6694(a)(1) of the Internal Revenue Code is modified to substitute the phrase "reasonable belief that the tax treatment in that position was more likely than not the proper treatment" instead of the phrase "realistic possibility of being sustained on its merits" contained therein.

(3) Section 6694(a)(3) of the Internal Revenue Code is modified to substitute the phrase "or there was no reasonable basis for the tax treatment of that position" instead of the phrase "or was frivolous" contained therein.

(c) Section 6694(b) of the Internal Revenue Code is modified to substitute "$5,000" for "$1,000."

(d) Section 6694(c) of the Internal Revenue Code shall not apply and, in lieu thereof, the following shall apply:

(1) If, within 30 days after the day on which notice and demand of any penalty under Section 6694(a) or 6694(b) of the Internal Revenue Code is made against any person who is an income tax return preparer, that person pays an amount which is not less than 15 percent of the amount of that penalty and files a claim for refund of the amount so paid, no levy or proceeding in court for the collection of the remainder of that penalty shall be made, begun, or prosecuted until the final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding Section 19381, the beginning of that proceeding or levy during the time that prohibition is in force may be enjoined in a proceeding in the superior court.

(2) If, within 30 days after the day on which a claim for refund of any partial payment of any penalty under Section 6694(a) or 6694(b) of the Internal Revenue Code is denied (or, if earlier, within 30 days after the expiration of six months after the day on which the claim for refund has been filed), the income tax return preparer fails to begin a proceeding in the superior court for the determination of his or her liability for that penalty, paragraph (1) shall cease to apply with respect to that penalty, effective on the day following the close of the applicable 30-day period referred to in this subdivision.

(3) The running of the period of limitations provided in Section 19371 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Franchise Tax Board is prohibited from collecting by levy or a proceeding in court.

SEC. 47.4. Section 19173 of the Revenue and Taxation Code is amended to read:

19173. (a) A penalty shall be imposed under this part for failure to maintain lists of advisees with respect to reportable transactions and shall be determined in accordance with Section 6708 of the Internal Revenue Code, except as otherwise provided.

(b) If a material advisor fails to meet the requirements of subdivision (d) of Section 18648 with respect to a listed transaction, as defined in

Section 6707A(c)(2) of the Internal Revenue Code, an additional penalty shall be imposed equal to the greater of:

(1) One hundred thousand dollars ($100,000).

(2) Fifty percent of the gross income that the material advisor derived from that activity.

(c) A penalty imposed under this section does not apply if it is shown that the additional information required under paragraph (1) of subdivision (d) of Section 18648 was not identified in a Franchise Tax Board notice issued prior to the date the transaction or shelter was entered into.

(d) The penalty imposed by subdivision (a) shall be assessed against the person required to maintain or provide a list under Section 18648. The penalty may be assessed at any time during the period ending eight years after the failure has occurred.

(e) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section with respect to a list required to be maintained or provided under Section 18648, if all of the following apply:

(A) The violation is with respect to a reportable transaction, other than a listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code.

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(f) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) shall not apply with respect to the assessment or collection of any penalty imposed by subdivision (a).

(g) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

SEC. 47.5. Section 19177 of the Revenue and Taxation Code is amended to read:

19177. A penalty shall be imposed for promoting abusive tax shelters and shall be determined in accordance with the provisions of Section 6700 of the Internal Revenue Code, except as otherwise provided.

SEC. 47.6. Section 19179 of the Revenue and Taxation Code is amended to read:

19179. A penalty shall be imposed for filing a frivolous return and shall be determined in accordance with Section 6702 of the Internal Revenue Code, except as otherwise provided.

(a) Section 6702 of the Internal Revenue Code shall be applied to returns required to be filed under this part.

(b) For taxpayers that have a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code with respect to which the requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code, Section 6702(a) of the Internal Revenue Code is modified as follows:

(1) By substituting "$5,000" instead of "$500."

(2) By substituting the term "person" instead of the term "individual" in each place that it appears.

(3) By substituting "tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part" instead of the phrase "tax imposed by subtitle A" contained therein.

(4) By substituting the phrase "is based on" instead of the phrase "is due to" contained therein.

(5) By substituting the phrase "frivolous or is based on a position that the Franchise Tax Board has identified as frivolous under subdivision (c) of Section 19179" instead of the term "frivolous" contained therein.

(6) By substituting the phrase "reflects a desire to delay or impede the administration of federal income tax laws as determined by the Secretary of the Treasury or the administration of the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part as determined by the Franchise Tax Board" instead of the phrase "a desire (which appears on the purported return) to delay or impede the administration of Federal income tax laws" contained therein.

(c) (1) The Franchise Tax Board shall prescribe (and periodically revise) a list of positions which the Secretary of the Treasury for federal income tax purposes or the Franchise Tax Board has identified as being frivolous for purposes of this section.

(2) Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to any standard, criterion, procedure, determination, rule, notice, or guideline established or prescribed by the Franchise Tax Board pursuant to paragraph (1).

(d) (1) Except as provided in paragraph (3), any person who submits a specified frivolous submission shall pay a penalty of five thousand dollars ($5,000).

(2) For purposes of this section, all of the following shall apply:

(A) The phrase "specified frivolous submission" means a specified submission if any portion of that submission meets any of the following conditions:

(i) Is based on a position which the Franchise Tax Board has identified as frivolous under subdivision (c).

(ii) Reflects a desire to delay or impede the administration of federal income tax laws as determined by the Secretary of the Treasury or the administration of the tax imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part as determined by the Franchise Tax Board.

(B) The phrase "specified submission" means any of the following:

(i) A protest under Section 19041.

(ii) A request for a hearing under Section 19044.

(iii) An application under any of the following sections:

(I) Section 19008 (relating to agreements for payment of tax liability in installments).

(II) Section 19443 (relating to compromises).

(III) Section 21004 (relating to actions of the Taxpayers' Rights Advocate).

(3) If the Franchise Tax Board provides a person with notice that a submission is a specified frivolous submission and the person withdraws that submission within 30 days after the notice, the penalty imposed under paragraph (1) does not apply with respect to that submission.

(e) (1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section if both of the following apply:

(A) Imposing the penalty would be against equity and good conscience.

(B) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(f) The penalties imposed by this section shall be in addition to any other penalty provided by law.

SEC. 47.7. Section 19182 of the Revenue and Taxation Code is amended to read:

19182. (a) A penalty shall be imposed for failure to furnish information pursuant to Section 18628 and shall be determined in accordance with Section 6707 of the Internal Revenue Code, relating to failure to furnish information regarding reportable transactions, except as otherwise provided.

(b) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) does not apply in respect of the assessment or collection of any penalty imposed under this section.

(c) A penalty under this section does not apply if it is shown that the additional information required under paragraph (2) of subdivision (d) of Section 18628 was not identified in a Franchise Tax Board notice issued prior to the date the transaction or shelter was entered into.

(d) The provisions of subdivision (e) of Section 19173, relating to the rescission of the penalty by the Chief Counsel of the Franchise Tax Board, shall apply to any penalty imposed by this section.

SEC. 48. Section 19184 of the Revenue and Taxation Code is amended to read:

19184. (a) A penalty of fifty dollars ($50) shall be imposed for each failure, unless it is shown that the failure is due to reasonable cause, by any person required to file who fails to file a report at the time and in the manner required by any of the following provisions:

(1) Subdivision (c) of Section 17507, relating to individual retirement accounts.

(2) Section 220(h) of the Internal Revenue Code, relating to medical savings accounts for taxable years beginning on or after January 1, 1997.

(3) Subdivision (b) of Section 17140.3 or subdivision (b) of Section 23711 relating to qualified tuition programs.

(4) Subdivision (e) of Section 23712, relating to Coverdell education savings accounts.

(b) (1) Any individual who:

(A) Is required to furnish information under Section 17508 as to the amount designated nondeductible contributions made for any taxable year, and

(B) Overstates the amount of those contributions made for that taxable year, shall pay a penalty of one hundred dollars ($100) for each overstatement unless it is shown that the overstatement is due to reasonable cause.

(2) Any individual who fails to file a form required to be filed by the Franchise Tax Board under Section 17508 shall pay a penalty of fifty dollars ($50) for each failure unless it is shown that the failure is due to reasonable cause.

(c) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) shall not apply in respect of the assessment or collection of any penalty imposed under this section.

SEC. 49. Section 19559 of the Revenue and Taxation Code, as added by Section 7 of Chapter 690 of the Statutes of 2002, is repealed.

SEC. 50. Section 19559 of the Revenue and Taxation Code, as added by Section 16 of Chapter 807 of the Statutes of 2002, is amended to read:

19559. (a) (1) The Franchise Tax Board may disclose returns and return information to federal agencies on the same terms and to the same extent as returns and return information may be disclosed by the Secretary of the Treasury under paragraph (3)(C) or paragraph (7) of Section 6103(i) of the Internal Revenue Code.

(2) Notwithstanding paragraph (1), the Franchise Tax Board may not disclose any return or return information under this section if the Franchise

Tax Board determines, in the manner specified by the Franchise Tax Board, that this disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

(b) This section shall apply to disclosures made on or after January 23, 2002, except that no disclosures may be made under this section after December 31, 2005.

SEC. 50.1. Section 19772 of the Revenue and Taxation Code, as added by Section 13 of Chapter 656 of the Statutes of 2003, is amended to read:

19772. (a) Section 6707A of the Internal Revenue Code, relating to penalty for failure to include reportable transactions information with a return, shall apply, except as otherwise provided.

(b) The penalty amounts in Section 6707A(b) of the Internal Revenue Code shall not apply, and in lieu thereof, the following shall apply:

(1) Except as provided in paragraph (2), the amount of the penalty shall be fifteen thousand dollars ($15,000).

(2) The amount of the penalty with respect to a listed transaction shall be thirty thousand dollars ($30,000).

(c) (1) Section 6707A(c)(1) of the Internal Revenue Code is modified to include reportable transactions within the meaning of paragraph (3) of subdivision (a) of Section 18407.

(2) Section 6707A(c)(2) of the Internal Revenue Code is modified to include listed transactions within the meaning of paragraph (4) of subdivision (a) of Section 18407.

(d) The penalty under this section only applies to taxpayers with taxable income greater than two hundred thousand dollars ($200,000).

(e) Section 6707A(e) of the Internal Revenue Code, relating to a penalty reported to the Securities and Exchange Commission, shall not apply.

(f) Section 6707A(d) of the Internal Revenue Code, relating to the authority to rescind a penalty, shall not apply, and in lieu thereof, the following shall apply:

(1) The Chief Counsel of the Franchise Tax Board may rescind all or any portion of any penalty imposed by this section with respect to any violation if all of the following apply:

(A) The violation is with respect to a reportable transaction other than a listed transaction.

(B) The person on whom the penalty is imposed has a history of complying with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(C) It is shown that the violation is due to an unintentional mistake of fact.

(D) Imposing the penalty would be against equity and good conscience.

(E) Rescinding the penalty would promote compliance with the requirements of this part and Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and effective tax administration.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

(g) Article 3 (commencing with Section 19031) of Chapter 4 (relating to deficiency assessments) shall not apply with respect to the assessment or collection of any penalty imposed under this section.

(h) The penalty imposed by this section is in addition to any penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

SEC. 50.2. Section 19772 of the Revenue and Taxation Code, as added by Section 13 of Chapter 654 of the Statutes of 2003, is repealed.

SEC. 50.3. Section 19773 of the Revenue and Taxation Code, as added by Section 13 of Chapter 656 of the Statutes of 2003, is repealed.

SEC. 50.4. Section 19773 of the Revenue and Taxation Code, as added by Section 13 of Chapter 654 of the Statutes of 2003, is repealed.

SEC. 50.5. Section 19774 of the Revenue and Taxation Code, as added by Section 13 of Chapter 656 of the Statutes of 2003, is amended to read:

19774. (a) If a taxpayer has a noneconomic substance transaction understatement for any taxable year, there shall be added to the tax an amount equal to 40 percent of the amount of that understatement.

(b) (1) Subdivision (a) shall be applied by substituting "20 percent" for "40 percent" with respect to the portion of any noneconomic substance transaction understatement with respect to which the relevant facts affecting the tax treatment of the item are adequately disclosed in the return or a statement attached to the return.

(2) For taxable years beginning before January 1, 2003, "adequately disclosed" includes the disclosure of the tax shelter identification number on the taxpayer's return as required by subdivision (c) of Section 18628, as applicable for the year in which the transaction was entered into.

(c) For purposes of this section:

(1) The term "noneconomic substance transaction understatement" means any amount which would be an understatement under Section 6662A(b) of the Internal Revenue Code, as modified by subdivision (b) of Section 19164.5 if Section 6662A(b) of the Internal Revenue Code were applied by taking into account items attributable to noneconomic substance transactions rather than items to which Section 6662A(b) applies.

(2) A "noneconomic substance transaction" includes the disallowance of any loss, deduction or credit, or addition to income attributable to a determination that the disallowance or addition is attributable to a transaction or arrangement that lacks economic substance including a transaction or arrangement in which an entity is disregarded as lacking economic substance. A transaction shall be treated as lacking economic

substance if the taxpayer does not have a valid nontax California business purpose for entering into the transaction.

(d) (1) If the notice of proposed assessment of additional tax has been sent with respect to a penalty to which this section applies, only the Chief Counsel of the Franchise Tax Board may compromise all or any portion of that penalty.

(2) The exercise of authority under paragraph (1) shall be at the sole discretion of the Chief Counsel of the Franchise Tax Board and may not be delegated.

(3) Notwithstanding any other law or rule of law, any determination under this subdivision may not be reviewed in any administrative or judicial proceeding.

SEC. 50.6. Section 19774 of the Revenue and Taxation Code, as added by Section 13 of Chapter 654 of the Statutes of 2003, is repealed.

SEC. 50.7. Section 19777 of the Revenue and Taxation Code, as amended by Section 331 of Chapter 183 of the Statutes of 2004, is amended to read:

19777. (a) If a taxpayer has been contacted by the Franchise Tax Board regarding a reportable transaction, as defined in Section 6707A(c)(1) of the Internal Revenue Code with respect to which the requirements of Section 6664(d)(2)(A) of the Internal Revenue Code are not met, any listed transaction, as defined in Section 6707A(c)(2) of the Internal Revenue Code, or a gross misstatement within the meaning of Section 6404(g)(2)(D) of the Internal Revenue Code, and has a deficiency, there shall be added to the tax an amount equal to 100 percent of the interest payable under Section 19101 for the period beginning on the last date prescribed by law for the payment of that tax (determined without regard to extensions) and ending on the date the notice of proposed assessment is mailed.

(b) The penalty imposed by this section is in addition to any other penalty imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part.

SEC. 50.8. Section 19777 of the Revenue and Taxation Code, as amended by Section 330 of Chapter 183 of the Statutes of 2004, is repealed.

SEC. 51. Section 23051.5 of the Revenue and Taxation Code is amended to read:

23051.5. (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 defined in paragraph (1) of subdivision (a) of Section 17024.5.

(2) (A) 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.

(B) In the case where Section 901 of the Economic Growth and Tax Relief Act of 2001 (Public Law 107-16) applies to any provision of the Internal Revenue Code that is incorporated for purposes of this part, Section 901 of the Economic Growth and Tax Relief Act of 2001 (Public Law 107-16) shall apply for purposes of this part in the same manner and to the same taxable years as it applies for federal income tax purposes.

(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 the Internal Revenue Code for purposes of this part, a reference to any of the following is not applicable for purposes of this part:

(1) Domestic International Sales Corporations (DISC), as defined in Section 992(a) of the Internal Revenue Code.

(2) Foreign Sales Corporations (FSC), as defined in Section 922(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) Federal tax credits and carryovers of federal tax credits.

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

(3) For taxable years beginning on and 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 issued 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 expressly 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) (A) Except as provided in subparagraph (B), in order to obtain treatment other than that elected for federal purposes, a separate election shall be filed with the Franchise Tax Board at the time and in the manner that may be required by the Franchise Tax Board.

(B) (i) If a taxpayer makes a proper election for federal income tax purposes prior to the time that taxpayer becomes subject to the tax imposed under this part or Part 10 (commencing with Section 17001), that taxpayer is deemed to have made the same election for purposes of the tax imposed by this part, Part 10 (commencing with Section 17001), and Part 10.2 (commencing with Section 18401), as applicable, and that taxpayer may not make a separate election for California tax purposes unless that separate election is expressly authorized by this part, Part 10 (commencing with Section 17001), or Part 10.2 (commencing with Section 18401), or by regulations issued by the Franchise Tax Board.

(ii) If a taxpayer has not made a proper election for federal income tax purposes prior to the time that taxpayer becomes subject to tax under this part or Part 10 (commencing with Section 17001), that taxpayer may not make a separate California election for purposes of this part, Part 10 (commencing with Section 17001), or Part 10.2 (commencing with Section 18401), unless that separate election is expressly authorized by this part, Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or by regulations issued by the Franchise Tax Board.

(iii) This subparagraph applies only to the extent that the provisions of the Internal Revenue Code or regulations issued by "the secretary" authorizing an election for federal income tax purposes apply for purposes of this part, Part 10 (commencing with Section 17001), or Part 10.2 (commencing with Section 18401).

(f) Whenever this part allows or requires a taxpayer to file an application or seek consent, the rules set forth in subdivision (e) shall apply 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) For purposes of Chapter 2 (commencing with Section 23101), Chapter 2.5 (commencing with Section 23400), and Chapter 3 (commencing with Section 23501), the term "taxable income" shall mean "net income."

(2) For purposes of Article 2 (commencing with Section 23731) of Chapter 4, the term "taxable income" shall mean "unrelated business taxable income," as defined by Section 23732.

(3) Any reference to "subtitle," "Chapter 1," 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.

(8) Any provision of the Internal Revenue Code that refers to a "corporation" shall, when applicable for purposes of this part, include a "bank," as defined by Section 23039.

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

SEC. 52. Section 23662 is added to the Revenue and Taxation Code, to read:

23662. (a) For each taxable year beginning on or after July 1, 2005, and before January 1, 2018, there shall be allowed as an environmental tax credit against the "tax," as defined by Section 23036, an amount equal to five cents ($0.05) for each gallon of ultra low sulfur diesel fuel produced during the taxable year by a small refiner at any facility located in this state.

(b) The aggregate credit determined under subdivision (a) for any taxable year with respect to any facility shall not exceed 25 percent of the qualified capital costs incurred by the small refiner with respect to that facility, reduced by the aggregate credits determined under this section for all prior taxable years with respect to that facility.

(c) For purposes of this section:

(1) "Small refiner" means any refiner who owns or operates a refinery in California that:

(A) Has and at all times had since January 1, 1978, a crude oil capacity of not more than 55,000 barrels per stream day.

(B) Has not been at any time since September 1, 1988, owned or controlled by any refiner that at the same time owned or controlled refineries in California with a total combined crude oil capacity of more than 55,000 barrels per stream day.

(C) Has not been at any time since September 1, 1988, owned or controlled by any refiner that at the same time owned or controlled refineries in the United States with a total combined crude oil capacity of more than 137,500 barrels per stream day.

(2) (A) "Qualified capital costs" means, with respect to any facility, those costs paid or incurred during the applicable period for items certified by the California Air Resources Board (CARB) under subparagraph (B) for compliance with the applicable EPA or CARB regulations with respect to that facility, including, but not limited to, expenditures for the construction of new process operation units or the dismantling and reconstruction of existing process units to be used in the production of ultra low sulfur diesel fuel, associated adjacent or offsite equipment (including tankage, catalyst, and power supply), engineering, construction period interest, site work, and permitting.

(B) (i) Before claiming a credit under this section, a small refiner shall request from the California Air Resources Board a certification that both of the following are true:

(I) That the items for which qualified capital costs were paid or incurred are for compliance with the applicable EPA or CARB regulations described in subparagraph (A).

(II) That the items for which qualified capital costs were paid or incurred have been placed in service by the small refiner.

(ii) The request described in clause (i) shall be in a form and contain sufficient information to allow the California Air Resources Board to determine that the items that are requested to be certified were placed in service for compliance with applicable EPA and CARB regulations, which information shall include the date on which the items were placed in service.

(C) The California Air Resources Board shall make a determination regarding a request described in subparagraph (B) on or before 60 days after the request is submitted. If the board does not make a determination within this time period, the certification will be deemed to be granted.

(D) If certification from the Secretary of the Treasury of the United States, after consultation with the Administrator of the Environmental Protection Agency, that the taxpayer's qualified capital costs with respect to a facility are, or will result, in compliance with applicable EPA regulations, has been received, then the taxpayer shall be allowed the credit without obtaining certification from the CARB, unless CARB demonstrates that the fuel produced does not meet CARB regulations.

(3) "Facility" means a small refiner's petroleum refinery located in the State of California that has incurred qualified capital costs to produce ultra low sulfur diesel fuel.

(4) "Applicable EPA regulations" means the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency.

(5) "Applicable CARB regulations" means the Vehicular Diesel Fuel Sulfur Control Requirements of the California Air Resources Board (CARB) under Section 2281 of Article 2 of Chapter 5 of Division 3 of Title 13 of the California Code of Regulations.

(6) "Applicable period" means, with respect to any facility, the period beginning on January 1, 2004, and ending on May 31, 2007.

(7) "Ultra low sulfur diesel fuel" means both of the following:

(A) Diesel fuel with a sulfur content of 15 parts per million or less.

(B) (i) Subject to clause (ii), either of the following:

(I) Vehicular diesel fuel produced and sold by a small refiner on or after June 1, 2006.

(II) Vehicular diesel fuel produced and sold by the small refiner before June 1, 2006, that the small refiner specifically identifies and supports through internal test reports as meeting applicable CARB regulations.

(ii) For purposes of this section, it is rebuttably presumed that the fuel described in clause (i) is ultra low sulfur diesel fuel. The California Air Resources Board may rebut this presumption by demonstrating that the fuel does not comply with applicable CARB regulations.

(8) "Barrels per stream day" means the maximum number of barrels of input that a distillation facility can process within a 24-hour period when running at full capacity under optimal crude and product slate conditions with no allowance for downtime.

(d) For purposes of this section, if a credit is determined under this section for any expenditure with respect to any property, the increase in basis of that property that would (but for this subdivision) result from that expenditure shall be reduced by the amount of the credit so determined.

(e) No deduction shall be allowed for that portion of the expenses otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for the taxable year under this section.

(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 the 10 succeeding years if necessary, until the credit is exhausted.

(g) If a small refiner that claims a credit under this section sells, transfers, or otherwise disposes of, either directly or indirectly, a facility within five years of the taxable year during which it first claimed the credit, there shall be added to the "tax" of the small refiner during the taxable year of sale, transfer, or disposition an amount equal to the total credit claimed multiplied by a fraction, the numerator of which is the remaining term of five years and the denominator of which is 5.

(h) This section shall remain in effect only until January 1, 2018, and as of that date is repealed.

SEC. 53. 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, relating to excess contributions under Section 4979, shall not apply.

SEC. 54. Section 23701w of the Revenue and Taxation Code is amended to read:

23701w. A veteran's organization, as defined by Section 501(c)(19) of the Internal Revenue Code.

SEC. 55. Section 23703.5 of the Revenue and Taxation Code is amended to read:

23703.5. Section 501(p) of the Internal Revenue Code, relating to suspension of tax-exempt status of terrorist organizations, shall apply, except as otherwise provided:

(a) References to Section 501(a) of the Internal Revenue Code shall be modified to refer to Section 23701.

(b) Section 501(p)(4) of the Internal Revenue Code is modified by substituting the phrase "under Part 10 (commencing with Section 17001) and this part" for the phrase "under any provision of this title, including Sections 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), and 2522" contained therein.

(c) This section shall apply only during the period described in Section 501(p)(3) of the Internal Revenue Code that the federal tax exemption of the organization described in Section 501(p)(2) of the Internal Revenue Code is suspended for federal income tax purposes under Section 501(p)(1) of the Internal Revenue Code.

(d) Section 501(p)(5) of the Internal Revenue Code shall not apply and in lieu thereof, notwithstanding any other provision of law, no organization or other person may challenge a suspension under this section, a designation or identification described in Section 501(p)(2) of the Internal Revenue Code, the period of suspension described in Section 501(p)(3) of the Internal Revenue Code, or a denial of a deduction under Section 501(p)(4) of the Internal Revenue Code as modified in subdivision (b) in any administrative or judicial proceeding relating to the California tax liability of the organization or other person.

(e) (1) Credit or refund (with interest) with respect to an overpayment shall be made if all of the following apply with respect to that overpayment:

(A) The tax exemption of any organization described in Section 501(p)(2) of the Internal Revenue Code is suspended under this section.

(B) Each designation and identification described in Section 501(p)(2) of the Internal Revenue Code which has been made with respect to that organization is determined to be erroneous under Section 501(p)(6) of the Internal Revenue Code for federal income tax purposes.

(C) The erroneous designations and identifications result in an overpayment of income tax for any taxable year by that organization.

(2) If the credit or refund of any overpayment of tax described in subparagraph (C) of paragraph (1) is prevented at any time by the operation of any law or rule of law (including res judicata), the credit or refund may nevertheless be allowed or made if the claim therefor is filed before the close of the one-year period beginning on the date of the last determination described in subparagraph (B) of paragraph (1).

(f) This section shall apply to designations made before, on, or after November 11, 2003.

SEC. 56. 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.

(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. 57. Section 23711 of the Revenue and Taxation Code is amended to read:

23711. Section 529 of the Internal Revenue Code, 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. 58. Section 23712 of the Revenue and Taxation Code is amended to read:

23712. Section 530 of the Internal Revenue Code, relating to Coverdell education savings 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 savings 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) 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 2½ 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 taxable years beginning before January 1, 2005:

(i) By additionally providing that Section 530(d)(4)(A) of the Internal Revenue Code, relating to additional tax for distributions not used for educational purposes, shall not apply if the payment or distribution is made on account of the attendance of the designated beneficiary at the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy, to the extent that the amount of the payment or distribution does not exceed the costs of advanced education (as defined by Section 2005(e)(3) of Title 10 of the United States Code, as in effect on November 11, 2003) attributable to that attendance.

(ii) The amendments made to this section by Section 12 of Chapter 552 of the Statutes of 2004 shall apply to taxable years beginning after December 31, 2002.

(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. 59. 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) For taxable years beginning on or after January 1, 1998, and before January 1, 2002, 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) For taxable years beginning on or after January 1, 1998, and before January 1, 2002:

(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 shall apply except as otherwise provided in Part 10 (commencing with Section 17001) and this part.

SEC. 60. Section 24349 of the Revenue and Taxation Code is amended to read:

24349. (a) There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) Of property used in the trade or business; or

(2) Of property held for the production of income.

(b) Except as otherwise provided in subdivision (c), for taxable years ending after December 31, 1958, the term "reasonable allowance" as used in subdivision (a) shall include, but shall not be limited to, an allowance computed in accordance with regulations prescribed by the Franchise Tax Board, under any of the following methods:

(1) The straight-line method.

(2) The declining balance method, using a rate not exceeding twice the rate that would have been used had the annual allowance been computed under the method described in paragraph (1).

(3) The sum of the years-digits method.

(4) Any other consistent method productive of an annual allowance that, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of those allowances that would have been used had those allowances been computed under the method described in paragraph (2).

Nothing in this subdivision shall be construed to limit or reduce an allowance otherwise allowable under subdivision (a).

(c) Any grapevine replaced in a vineyard in California in a taxable year beginning on or after January 1, 1992, as a direct result of a phylloxera infestation in that vineyard, and any grapevine replaced in a vineyard in California in a taxable year beginning on or after January 1, 1997, as a direct result of Pierce's disease in that vineyard, shall have a useful life of five years, except that it shall have a class life of 10 years for purposes of depreciation under Section 168(g)(2) of the Internal Revenue Code where the taxpayer has made an election under Section 263A(d)(3) of the Internal Revenue Code not to capitalize costs of the infested vineyard. Every taxpayer claiming a deduction under this section with respect to a

grapevine as described in this subdivision shall obtain a written certification from an independent state-certified integrated pest management adviser, or a state agricultural commissioner or adviser, that specifies that the replanting was necessary to restore a vineyard infested with phylloxera or Pierce's disease. The taxpayer shall retain the certification for future audit purposes.

(d) For purposes of this part, the deduction for property leased to governments and other tax-exempt entities, as defined in Section 168(h) of the Internal Revenue Code, shall be limited to the amount determined under Section 168(g) of the Internal Revenue Code, relating to alternative depreciation system for certain property.

(e) (1) In the case of any building erected or improvements made on leased property, if the building or improvement is property to which this section applies, the depreciation deduction shall be determined under the provisions of this section.

(2) An improvement shall be treated for purposes of determining gain or loss under this part as disposed of by the lessor when so disposed of or abandoned if both of the following occur:

(A) The improvement is made by the lessor of leased property for the lessee of that property.

(B) The improvement is irrevocably disposed of or abandoned by the lessor at the termination of the lease by the lessee.

This subdivision shall not apply to any property to which Section 168 of the Internal Revenue Code does not apply for federal purposes by reason of Section 168(f) of the Internal Revenue Code. Any election made under Section 168(f)(1) of the Internal Revenue Code for federal purposes with respect to that property shall be treated as a binding election for state purposes under this subdivision with respect to that same property and no separate election under subdivision (e) of Section 23051.5 with respect to that property shall be allowed.

(3) (A) In determining a lease term, both of the following shall apply:

(i) There shall be taken into account options to renew.

(ii) Two or more successive leases which are part of the same transaction (or a series of related transactions) with respect to the same or substantially similar property shall be treated as one lease.

(B) For purposes of clause (i) of subparagraph (A), in the case of nonresidential real property or residential rental property, there shall not be taken into account any option to renew at fair market value determined at the time of renewal.

(f) (1) Section 167(g) of the Internal Revenue Code, relating to depreciation under income forecast method, shall apply except as otherwise provided.

(2) Section 167(g)(2)(C) of the Internal Revenue Code is modified by substituting "Section 19521" in lieu of "Section 460(b)(7)" of the Internal Revenue Code.

(3) Section 167(g)(5)(D) of the Internal Revenue Code is modified by substituting "Part 10.2 (commencing with Section 18401) (other than

Article 2 (commencing with Section 19021) and Sections 19142 to 19150, inclusive)" in lieu of "Subtitle F (other than Sections 6654 and 6655)."

(4) Section 167(g)(5)(E) of the Internal Revenue Code, relating to treatment of distribution costs, shall not apply.

(5) Section 167(g)(7) of the Internal Revenue Code, relating to treatment of participations and residuals, shall not apply.

SEC. 61. Section 24355.3 is added to the Revenue and Taxation Code, to read:

24355.3. For purposes of computing the depreciation deduction pursuant to Section 24349, the useful life of any motor sports entertainment complex, as defined in Section 168(i)(15) of the Internal Revenue Code, shall be seven years.

SEC. 61.5. Section 24355.4 is added to the Revenue and Taxation Code, to read:

24355.4. For purposes of computing the depreciation deduction pursuant to Section 24349, the useful life of any Alaska natural gas pipeline, as defined in Section 168(i)(16) of the Internal Revenue Code, shall be seven years.

SEC. 61.7. Section 24356 of the Revenue and Taxation Code is amended to read:

24356. (a) (1) In the case of Section 24356 property, the term "reasonable allowance" as used in subdivision (a) of Section 24349, may, at the election of the taxpayer, include an allowance, for the first taxable year for which a deduction is allowable under Sections 24349 through 24354 to the taxpayer with respect to such property, of 20 percent of the cost of that property.

(2) If in any one taxable year the cost of Section 24349 property with respect to which the taxpayer may elect an allowance under paragraph (1) for that taxable year exceeds ten thousand dollars ($10,000), then paragraph (1) shall apply with respect to those items selected by the taxpayer, but only to the extent of an aggregate cost of ten thousand dollars ($10,000).

(b) (1) In lieu of subdivision (a), Section 179 of the Internal Revenue Code, relating to the election to expense certain depreciable business assets, shall apply, except as otherwise provided.

(2) Section 179(b)(1) of the Internal Revenue Code, relating to the dollar limitation, shall not apply and in lieu thereof, the aggregate cost that may be taken into account under Section 179(a) of the Internal Revenue Code, for any taxable year, shall not exceed twenty-five thousand dollars ($25,000).

(3) Section 179(b)(2) of the Internal Revenue Code, relating to the reduction in the dollar limitation, shall not apply and in lieu thereof, the limitation under paragraph (2), for any taxable year, shall be reduced, but not below zero, by the amount by which the cost of Section 179 property, as defined in Section 179(d)(1) of the Internal Revenue Code, except as otherwise provided, that is placed in service during the taxable year, exceeds two hundred thousand dollars ($200,000).

(4) Section 179 of the Internal Revenue Code is modified to provide that the "aggregate amount disallowed" referred to in Section 179(b)(3)(B) of the Internal Revenue Code shall be computed under this part as that section read on the date the property generating the amount disallowed was placed in service.

(5) Section 179(b)(5) of the Internal Revenue Code, relating to inflation adjustments, shall not apply.

(6) The last sentence in Section 179(c)(2) of the Internal Revenue Code, relating to irrevocable elections, shall not apply.

(7) Section 179(d)(1)(A)(ii) of the Internal Revenue Code, relating to computer software, shall not apply.

(c) (1) The election under this section for any taxable year shall be made within the time prescribed by law (including extensions thereof) for filing the return for such taxable year. The election shall be made in such manner as the Franchise Tax Board may by regulations prescribe.

(2) Any election made under this section may not be revoked except with the consent of the Franchise Tax Board.

(d) (1) For purposes of this section, the term "Section 24356 property" means tangible personal property—

(A) Of a character subject to the allowance for depreciation under Sections 24349 through 24354,

(B) Acquired by purchase after December 31, 1958, for use in a trade or business, and

(C) With a useful life (determined at the time of such acquisition) of six years or more.

(2) For purposes of paragraph (1), the term "purchase" means any acquisition of property, but only if—

(A) The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under Section 24427 (but, in applying Section 267 of the Internal Revenue Code, relating to losses, expenses, and interest with respect to transactions between related taxpayers, for purposes of this section, Section 267(c)(4) of the Internal Revenue Code shall be treated as providing that the family of an individual shall include only his or her spouse, ancestors, and lineal descendants);

(B) The property is not acquired by one member of an affiliated group from another member of the same affiliated group, and

(C) The basis of the property in the hands of the person acquiring it is not determined in whole or in part by reference to the adjusted basis of that property in the hands of the person from whom acquired.

(3) For purposes of this section, the cost of property does not include so much of the basis of such property as is determined by reference to the basis of other property held at any time by the person acquiring that property.

(4) For purposes of subdivision (a) and subdivision (b) of this section—

(A) All members of an affiliated group shall be treated as one taxpayer, and

(B) The Franchise Tax Board shall apportion the dollar limitation contained in subdivision (a) or subdivision (b) among the members of the affiliated group in the manner as it shall by regulations prescribe.

(5) For purposes of paragraphs (2) and (4), the term "affiliated group" has the meaning assigned to it by Section 1504 of the Internal Revenue Code, except that, for those purposes, the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in Section 1504(a) of the Internal Revenue Code.

(6) In applying Section 24353, the adjustment under paragraph (1) of subdivision (b) of Section 24916, resulting by reason of an election made under this section with respect to any Section 24356 property, shall be made before any other deduction allowed by subdivision (a) of Section 24349 is computed.

(e) The Franchise Tax Board shall prescribe those regulations as may be necessary to carry out the purposes of this section.

SEC. 62. Section 24356.4 is added to the Revenue and Taxation Code, to read:

24356.4. (a) For any taxable year, which includes part of the "applicable period," as defined in paragraph (6) of subdivision (c) of Section 23662, a small refiner (as defined in Section 23662) may elect to treat 75 percent of qualified capital costs (as defined in paragraph (2) of subdivision (c) of Section 23662) paid or incurred by the taxpayer during the taxable year as expenses that are not chargeable to a capital account. Any cost so treated shall be allowed as a deduction for the taxable year in which paid or incurred.

(b) (1) For purposes of this part, the basis of any property shall be reduced by the portion of the cost of that property taken into account under subdivision (a).

(2) For purposes of Section 1245 of the Internal Revenue Code, and corresponding section of this part, the amount of the deduction allowable under subdivision (a) with respect to any property which is of a character subject to the allowance for depreciation shall be treated as a deduction allowed for depreciation under Section 167 of the Internal Revenue Code, or the corresponding section of this part.

(c) This section is repealed on January 1, 2009.

SEC. 63. Section 24356.5 of the Revenue and Taxation Code is repealed.

SEC. 64. Section 24369.4 of the Revenue and Taxation Code is amended to read:

24369.4. (a) Section 198 of the Internal Revenue Code, relating to expensing of environmental remediation costs, shall apply, except as otherwise provided.

(b) Section 198(b)(2) is modified to refer to Sections 24349 to 24355, inclusive, in lieu of Section 167 of the Internal Revenue Code.

(c) Section 198(f) is modified to refer to Section 24442 in lieu of Section 280B of the Internal Revenue Code.

(d) For expenditures paid or incurred before January 1, 2004, each of the following shall apply:

(1) If a taxpayer has, at any time, made an election for federal purposes under Section 198(a) of the Internal Revenue Code to have Section 198 of the Internal Revenue Code apply to a qualified environmental remediation expenditure, Section 198 of the Internal Revenue Code shall apply to that qualified environmental remediation expenditure 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 an election for federal purposes under Section 198(a) of the Internal Revenue Code to have Section 198 of the Internal Revenue Code apply to a qualified environmental remediation expenditure, an election under Section 198(a) of the Internal Revenue Code shall not be allowed for state purposes, Section 198 of the Internal Revenue Code shall not apply to that qualified environmental remediation expenditure for state purposes, and a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.

(e) No inference as to the proper treatment for purposes of this part of qualified environmental remediation expenditures for periods before the enactment of this section shall be made.

(f) Section 198(h) of the Internal Revenue Code, relating to termination, shall not apply.

(g) Section 198 of the Internal Revenue Code, relating to expensing of environmental remediation costs, shall not apply to expenditures paid or incurred after December 31, 2003.

SEC. 65. Section 24406.6 is added to the Revenue and Taxation Code, to read:

24406.6. For purposes of Section 24373.5, and Sections 24404 to 24406.5, inclusive, net earnings shall not be reduced by amounts paid during the year as dividends on capital stock or other proprietary capital interests of the organization to the extent that the articles of incorporation, bylaws of the organization, or other contract with patrons provide that those dividends are in addition to amounts otherwise payable to patrons that are derived from business done for or with patrons during the taxable year.

SEC. 66. Section 24407 of the Revenue and Taxation Code is amended to read:

24407. (a) The organizational expenditures of a corporation may, at the election of the corporation (made in accordance with regulations prescribed by the Franchise Tax Board), be treated as deferred expenses. In computing net income, the deferred expenses remaining, if any, after the application of subdivision (b) shall be allowed as a deduction ratably over that period of not less than 180 months as may be selected by the corporation (beginning with the month in which the corporation begins business).

(b) (1) The corporation shall be allowed a deduction for the deferred expenses under subdivision (a) in an amount equal to the lesser of either of the following:

(A) The amount of organizational expenditures of the taxpayer that are treated as deferred expenses under subdivision (a).

(B) Five thousand dollars ($5,000), reduced, but not below zero, by an amount equal to the excess of the amount of the taxpayer's organizational expenditures treated as deferred expenses under subdivision (a) over fifty thousand dollars ($50,000).

(2) The deduction under paragraph (1) shall be allowed in the taxable year in which the first month of the period specified in subdivision (a) occurs.

(c) The amendments made to this section by the act adding this subdivision shall apply to amounts paid or incurred on or after January 1, 2005.

SEC. 67. Section 24601 of the Revenue and Taxation Code is amended to read:

24601. (a) Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to deferred compensation, etc., shall apply, except as otherwise provided.

(b) Notwithstanding the date specified in paragraph (1) of subdivision (a) of Section 23051.5, Part I of Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to pension, profitsharing, stock bonus plans, etc., shall apply, except as otherwise provided, without regard to taxable year to the same extent as applicable for federal income tax purposes.

SEC. 68. Section 24654 of the Revenue and Taxation Code is amended to read:

24654. (a) Section 448 of the Internal Revenue Code, relating to limitation on use of cash method of accounting, shall apply, except as otherwise provided.

(b) For purposes of applying Section 448 of the Internal Revenue Code, Sections 801(d)(2), 801(d)(3), and 801(d)(5) of the Tax Reform Act of 1986 (Public Law 99-514), as modified by Section 1008(a) of Public Law 100-647, shall apply to each taxable year beginning on or after January 1, 1987.

SEC. 69. Section 24661.5 of the Revenue and Taxation Code is amended to read:

24661.5. Section 451(e)(3) of the Internal Revenue Code, relating to special election rule, is modified by substituting the phrase "subdivision (b) of Section 24949.1" in lieu of the phrase "section 1033(e)(2)" contained therein.

SEC. 70. Section 24661.6 is added to the Revenue and Taxation Code, to read:

24661.6. Section 451(i) of the Internal Revenue Code, relating to special rule for sales or dispositions to implement Federal Energy

Regulatory Commission or state electric restructuring policy, shall not apply.

SEC. 71. Section 24694 is added to the Revenue and Taxation Code, to read:

24694. Section 470 of the Internal Revenue Code, relating to limitation on deductions allocable to property used by governments or other tax-exempt entities, shall apply, except as otherwise provided.

SEC. 72. Section 24831.6 is added to the Revenue and Taxation Code, to read:

24831.6. Section 613A(c)(6)(H) of the Internal Revenue Code, relating to temporary suspension of taxable income limit with respect to marginal production, shall not apply.

SEC. 73. Section 24872 of the Revenue and Taxation Code is amended to read:

24872. (a) A real estate investment trust shall be deemed to have satisfied the distribution requirements of Section 857(a)(1) of the Internal Revenue Code for purposes of this part if it satisfies the distribution requirements of Section 857(a)(1) of the Internal Revenue Code for federal purposes.

(b) (1) Section 857(b)(1) of the Internal Revenue Code, relating to imposition of tax on real estate investment trusts, shall not apply.

(2) Every real estate investment trust shall be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except that its "net income" shall be equal to its "real estate investment trust income," as defined in subdivision (c).

(c) "Real estate investment trust income" means real estate investment company taxable income, as defined in Section 857(b)(2) of the Internal Revenue Code, modified as follows:

(1) In lieu of Section 857(b)(2)(A) of the Internal Revenue Code, relating to special deductions for corporations, no deduction shall be allowed under Section 24402.

(2) Section 857(b)(2)(D) of the Internal Revenue Code, relating to an exclusion for an amount equal to the net income from foreclosure property, shall not apply.

(3) Section 857(b)(2)(E) of the Internal Revenue Code, relating to a deduction for an amount equal to the tax imposed in the case of failure to meet certain requirements for the taxable year, shall not apply.

(4) Section 857(b)(2)(F) of the Internal Revenue Code, relating to an exclusion for an amount equal to any net income derived from prohibited transactions, shall not apply.

(d) Section 857(b)(3) of the Internal Revenue Code, relating to an alternative tax in case of capital gains, shall not apply.

(e) Section 857(b)(4)(A) of the Internal Revenue Code, relating to the imposition of tax on income from foreclosure property, shall not apply.

(f) Section 857(b)(5) of the Internal Revenue Code, relating to the imposition of tax in case of failure to meet certain requirements, shall not apply.

(g) Section 857(b)(6)(A) of the Internal Revenue Code, relating to the imposition of tax on income from prohibited transactions, shall not apply.

(h) Section 857(b)(7) of the Internal Revenue Code, relating to income from redetermined rents, redetermined deductions, and excess interest, shall not apply.

(i) Section 857(c) of the Internal Revenue Code, relating to restrictions applicable to dividends received from real estate investment trusts, is modified to refer to Sections 24402, 24406, 24410, and 25106, in lieu of Section 243 of the Internal Revenue Code.

(j) The amendments to this section by Chapter 878 of the Statutes of 1993 are clarifications of legislative intent and shall apply to taxable years beginning on or after January 1, 1987.

SEC. 74. Section 24949.1 of the Revenue and Taxation Code is amended to read:

24949.1. (a) 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.

(b) (1) In the case of drought, flood, or other weather-related conditions described in subdivision (a) that result in the area being designated as eligible for assistance by the federal government, subdivision (b) of Section 24944 shall be applied with respect to any converted property by substituting "four years" for "two years."

(2) The Franchise Tax Board may extend the period for replacement under Sections 24943 to 24949, inclusive (after the application of paragraph (1)), for the additional time as the Franchise Tax Board determines appropriate if the weather-related conditions that resulted in the application of paragraph (1) continue for more than three years.

SEC. 75. Section 24949.3 of the Revenue and Taxation Code is amended to read:

24949.3. For purposes of Sections 24943 through 24946, if, because of drought, flood, other weather-related conditions, or soil contamination or other environmental contamination, it is not feasible for the taxpayer to reinvest the proceeds from compulsorily or involuntarily converted livestock in property similar or related in use to the livestock so converted, other property (including real property in the case of soil contamination or other environmental contamination) used for farming purposes shall be treated as property similar or related in service or use to the livestock so converted.

SEC. 76. Sections 411 to 418, inclusive, of the Job Creation and Worker Assistance Act of 2002 (Subtitle B of Title IV of Public Law

107-147) and Sections 401 to 408, inclusive, of the Working Families Tax Relief Act of 2004 (Public Law 108-311) enacted numerous technical corrections to provisions of the Internal Revenue Code, including technical corrections relating to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Public Law 108-173), the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108-27), the Job Creation and Worker Assistance Act of 2002 (Public Law 107-147), the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), the Community Renewal Tax Relief Act of 2000 as part of the Consolidated Appropriations Act, 2001 (Public Law 106-554), the Tax Relief Extension Act of 1999 as part of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106-170), the Taxpayer Relief Act of 1997 (Public Law 105-34), the Balanced Budget Act of 1997 (Public Law 105-33), and the Small Business Job Protection Act of 1996 (Public Law 104-188), some of which are incorporated by 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 Job Creation and Worker Assistance Act of 2002 (Subtitle B of Title IV of Public Law 107-147) and the Working Families Tax Relief Act of 2004 (Public Law 108-311), or if later, the specified date of incorporation.

SEC. 77. Section 44 of this bill incorporates amendments to Section 19008 of the Revenue and Taxation Code proposed by this bill and SB 157. It shall not become operative if (1) both bills are enacted and become effective on or before January 1, 2006, (2) each bill amends Section 19008 of the Revenue and Taxation Code, and (3) this bill is enacted after SB 157.

SEC. 78. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

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