Assembly Bill No. 2797

CHAPTER 322

An act to amend Section 13340 of the Government Code, to amend Sections 10759, 10901, 10902, 17024.5, 17052.25, 17053.5, 17054, 17062, 17073.5, 17088.5, 17088.6, 17132.6, 17152, 17276, 17279.5, 17507.6, 17559, 17564, 17570, 17760.5, 17856, 18037.3, 18042, 18178, 18505, 18510, 18572, 18641, 18645, 19057, 19132, 19133.5, 19136, 19141.2, 19141.5, 19182, 19184, 19521, 19524, 20514, 20543, 20544, 23456, 23701t, 23704, 23712, 23771, 23800.5, 23801, 24349, 24357.7, 24357.8, 24402, 24416, 24424, 24611, 24652.5, 24661.5, 24673.2, 24710, 24871.5, 24872.4, 24872.5, 24872.7, 24875.5, 24949.1, and 24994 of, to amend and renumber Section 19721.6 of, to add Sections 10754, 11000, 17062.5, 17140.3, 17279.4, 17751, 17752, 17865, 18038.4, 19066.5, 19136.6, 23455.5, 23704.3, 23711, 24309.5, 24355.4, 24357.9, 24369.4, and 24954.1 to, to add and repeal Sections 11000.1, 17053.36, 17053.37, 17273.1, 23636, and 23637 of, to repeal Sections 17085.8, 17210.6, 17507.4, and 18037.6 of, to repeal and amend Section 24954 of, and to repeal and add Section 23806 of, the Revenue and Taxation Code, and to add Sections 9551.2 and 9554.1 to, and to add and repeal Section 9551.1 of, the Vehicle Code, relating to taxation, and making an appropriation therefor, to take effect immediately, tax levy.

[Approved by Governor August 20, 1998. Filed with Secretary of State August 20, 1998.]

LEGISLATIVE COUNSEL'S DIGEST

AB 2797, Cardoza. Taxes: fees.

The Personal Income Tax Law authorizes various credits against the taxes imposed by that law, including a refundable credit for qualified renters. If the credit allowed to a qualified renter exceeds the renter's tax liability under the Personal Income Tax Law, the excess is credited against other amounts due, if any, from the qualified renter and the balance is refunded to the qualified renter.

This bill would provide that the credit is nonrefundable and would limit the credit to persons whose taxable income is less than specified amounts that would be revised annually, based on an inflation adjustment factor.

The Personal Income Tax Law and the Bank and Corporation Tax Law authorize various credits against the taxes imposed by those laws.

This bill would authorize a credit against those taxes for each taxable and income year beginning on or after January 1, 2001, and before January 1, 2006, in an amount equal to a specified percentage of the qualified wages, as defined, paid or incurred during the taxable

or income year or in connection with an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter, as specified. This bill would also authorize a credit against those taxes for each taxable and income year beginning on or after January 1, 2001, and before January 1, 2006, in an amount equal to 10% of the qualified cost, as provided, of property for use in the manufacture of a product for ultimate use in a Joint Strike Fighter, as specified, that is placed in service in this state.

The Personal Income Tax Law authorizes a credit of $120 against those taxes for each taxable year beginning on or after January 1, 1998, and before January 1, 1999, and a credit of $222 for each taxable year beginning on or after January 1, 1999, adjusted for inflation thereafter, as specified, for each dependent.

This bill would instead authorize a credit of $253 against those taxes for each taxable year beginning on or after January 1, 1998, and before January 1, 1999, $227 for taxable years beginning on or after January 1, 1999, and adjusted for inflation, as specified, for each dependent.

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, various provisions of the federal Internal Revenue Code as enacted as of a specified date are referenced in various sections of the Revenue and Taxation Code. That law provides that for taxable years beginning on or after January 1, 1997, the specified date of those referenced Internal Revenue Code sections is January 1, 1997, unless otherwise specifically provided.

Existing law provides that for any introduced bill which proposes changes in any of those dates, the Franchise Tax Board shall 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, 1998, for taxable years beginning on or after January 1, 1998, and thereby would make numerous substantive changes to both the Personal Income Tax Law and the Bank and Corporation Tax Law with respect to those areas of preexisting conformity that are subject to changes under federal laws enacted after January 1, 1997, and that have not been or are not being excepted or modified.

This bill would make certain other changes in federal income tax laws applicable, with specified exceptions and modifications, and make specified supplemental, technical, or clarifying changes, for purposes of the Personal Income Tax Law or the Bank and Corporation Tax Law, or both, with respect to, among other things, the following subjects: controlled foreign partnerships; transfers of

property to foreign partnerships; extension of statute of limitations for foreign transfers; basic standard deduction and minimum tax exemption amount for certain dependents; increase in estimated tax de minimus threshold; modifications to look-back method; qualified lessee construction allowances; electing large partnerships; maximum number of shareholders of REIT's; tenant services income; attribution rules applicable to stock ownership; earnings and profits of REIT's; treatment of foreclosure property; treatment under hedging instruments; excess noncash income; prohibited transaction safe harbor; shared appreciation mortgages; wholly owned subsidiaries; regulated investment companies; penalties; statute of limitations; awarding of administrative costs; certain revocable trusts treated as part of estate; distributions of an estate; separate share rules for estates; treatment of funeral trusts; survivor benefits for public safety officers killed in the line of duty; the Small Business Job Protection Act of 1996; tax treatment of hospitals; ACE adjustment for AMT; association of holders of timeshare interests; certain receivables purchased by cooperative hospital service organizations; mark to market election; pooled debt obligations subject to acceleration; holding period for dividends received deduction; reporting of certain payments made to attorneys; returns of beneficiaries of estates and trusts; confidential corporate tax shelters; sale or exchange of partnership interest; termination of suspense accounts for certain family corporations; net operating loss carryovers; denial of deduction for certain amounts paid in connection with insurance; limitation on property for which an income forecast method may be used; waiver of estimated tax penalties; education credits; deduction for interest on education loans; penalty-free withdrawals from IRAs for higher education; qualified state tuition programs; education IRAs; deduction for corporate contributions of computer technology and equipment for elementary or secondary school purposes; treatment of cancellation of certain student loans; restoration of IRA deductions for certain taxpayers; establishment of nondeductible, tax-free IRAs; distributions from certain plans for use without penalty to purchase a first home; certain bullion not treated as collectibles; exemption from tax for gain on sale of a principal residence; rollover of gain from sale of qualified stock; repeal of separate depreciation lives for AMT purposes; AMT not to apply to farmers' installment sales; carryover basis for inherited property; treatment of livestock sold on account of weather-related conditions; expensing of environmental remediation costs; workers' compensation; UBTI exclusion for sponsorship payments; large corporate underpayments; and gain on certain sales of agricultural refiners and processors.

The Personal Income Tax Law, by reference to specified federal statutes, allows a deduction for 25% of the amount paid or incurred during the taxable year by a self-employed individual for insurance

that constitutes medical care for the taxpayer and his or her spouse and dependents. Existing federal law incrementally increases that deduction to specified percentage rates. Under federal law, a 45% deduction is allowed for taxable years beginning in calendar year 1998; when fully increased, a 100% deduction is allowed for taxable years beginning in calendar year 2007 or thereafter.

This bill would increase the deduction allowed under the Personal Income Tax Law to 40% of the amount paid or incurred for each taxable year beginning on or after January 1, 1999.

This bill would also make specified changes relating to subchapter ''S'' elections, as provided.

The Gonsalves-Deukmejian-Petris Senior Citizens Property Tax Assistance Law provides for payment of assistance by the Franchise Tax Board to claimants, whether those claimants own or rent their residence, in accordance with schedules that reduce the amount of assistance provided as the amount of a claimant's household income increases along a specified scale of household income amounts. It prohibits the Franchise Tax Board from paying any assistance if the gross household income of a claimant, after certain allowances, exceeds $24,000.

This bill would apply inflation adjustment factors, as provided, to the household income amounts that are set forth in the schedule that determines the amount of assistance in the case in which a claimant owns or rents his or her residence, and would apply similar inflation adjustments to the $24,000 gross household income figure.

The Vehicle License Fee Law establishes, in lieu of any ad valorem property tax upon vehicles, an annual license fee for any vehicle subject to registration in this state in the amount of 2% of the market value of that vehicle, as specified. It generally requires that vehicle license fee revenues be deposited in the Motor Vehicle License Fee Account in the Transportation Tax Fund and appropriates those revenues for, among other things, allocation to the Local Revenue Fund, a continuously appropriated fund established by a specified statute, and for allocation on a monthly basis among cities and counties in accordance with certain formulas.

This bill would permanently offset the amount of the vehicle license fee for each subject vehicle by 25%, and would, subject to specified contingencies with respect to fiscal year projections of State General Fund revenues, provide for the implementation of similar, superseding offsets of 35%, 46.5%, 55%, and 67.5% to apply to specified future calendar years. This bill would also make a continuous appropriation by requiring the transfer from the General Fund to the Motor Vehicle License Fee Account and the Local Revenue Fund of those sums that would offset the vehicle license fee revenue reductions resulting from this bill. This bill would, as provided, condition the amount of the reductions specified by this bill upon the availability of moneys for transfer from the General Fund

to fully fund the offsets. This bill would also make other conforming changes.

This bill would make additional technical, nonsubstantive changes to various provisions.

This bill would take effect immediately as a tax levy.

Appropriation: yes.

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

SECTION 1. Section 13340 of the Government Code is amended to read:

13340. (a) Except as provided in subdivision (b), on and after July 1, 1998, no moneys in that fund that, by any statute other than a Budget Act, is continuously appropriated without regard to fiscal years, may be encumbered unless the Legislature, by statute, specifies that the moneys in the fund are appropriated for encumbrance.

(b) Subdivision (a) does not apply to any of the following:

(1) The scheduled disbursement of any local sales and use tax proceeds to an entity of local government pursuant to Part 1.5 (commencing with Section 7200) of Division 2 of the Revenue and Taxation Code.

(2) The scheduled disbursement of any transactions and use tax proceeds to an entity of local government pursuant to Part 1.6 (commencing with Section 7251) of Division 2 of the Revenue and Taxation Code.

(3) The scheduled disbursement of any funds by a state or local agency or department that issues bonds and administers related programs for which funds are continuously appropriated as of June 30, 1998.

(4) Moneys that are deposited in proprietary or fiduciary funds of the California State University and that are continuously appropriated without regard to fiscal years.

(5) The scheduled disbursement of any motor vehicle license fee revenues, including the General Fund appropriations made pursuant to Sections 11000 and 11000.1 of the Revenue and Taxation Code, to an entity of local government pursuant to the Vehicle License Fee Law (Part 5 (commencing with Section 10701) of Division 2 of the Revenue and Taxation Code).

SEC. 2. Section 10754 is added to the Revenue and Taxation Code, to read:

10754. (a) Notwithstanding any other provision of law, the total amount of the vehicle license fee otherwise required with respect to a vehicle shall be offset in accordance with those provisions set forth below that are operative pursuant to subdivision (b):

(1) (A) For any initial or original registration of any vehicle, never before registered in this state, for which the final due date for

the license fee is on or after January 1 of any calendar year for which this paragraph is operative, and for any renewal of registration with an expiration date on or after January 1 of any calendar year for which this paragraph is operative, the department shall offset the total amount of fees otherwise due at the time of registration of that vehicle by an amount equal to 25 percent of the amount computed pursuant to Section 10752 or 10752.1, or Section 18115 of the Health and Safety Code.

(B) Upon proper payment of license fees to the Department of Motor Vehicles, the amount of the offset for each vehicle shall be transferred into the Motor Vehicle License Fee Account in the Transportation Tax Fund, and into the Local Revenue Fund, pursuant to Section 11000 or Section 11000.1, as applicable.

(C) During any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets required by subparagraph (A), within 90 days of a reduction of funding, the department shall reduce the amount of each offset computed pursuant to that subparagraph by multiplying that amount by the ratio of the amount of moneys actually available to be transferred from the General Fund to pay for those offsets to the amount of moneys that is necessary to fully fund those offsets.

(2) (A) For any initial or original registration of any vehicle, never before registered in this state, for which the final due date for the license fee is on or after January 1 of any calendar year for which this paragraph is operative, and for any renewal of registration with an expiration date on or after January 1 of any calendar year for which this paragraph is operative, the department shall offset the total amount of fees otherwise due at the time of registration of that vehicle by an amount equal to 35 percent of the amount computed pursuant to Section 10752 or 10752.1, or Section 18115 of the Health and Safety Code.

(B) Upon proper payment of license fees to the Department of Motor Vehicles, the amount of the offset for each vehicle shall be transferred into the Motor Vehicle License Fee Account in the Transportation Tax Fund, and into the Local Revenue Fund, pursuant to Section 11000 or Section 11000.1, as applicable.

(C) During any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets required by subparagraph (A), within 90 days of a reduction of funding, the department shall reduce the amount of each offset computed pursuant to that subparagraph by multiplying that amount by the ratio of the amount of moneys actually available to be transferred from the General Fund to pay for those offsets to the amount of moneys that is necessary to fully fund those offsets.

(3) (A) For any initial or original registration of any vehicle, never before registered in this state, for which the final due date for the license fee is on or after January 1 of any calendar year for which

this paragraph is operative, and for any renewal of registration with an expiration date on or after January 1 of any calendar year for which this paragraph is operative, the department shall offset the total amount of fees otherwise due at the time of registration of that vehicle by an amount equal to $46^1/_2$ percent of the amount computed pursuant to Section 10752 or 10752.1, or Section 18115 of the Health and Safety Code.

(B) Upon proper payment of license fees to the Department of Motor Vehicles, the amount of the offset for each vehicle shall be transferred into the Motor Vehicle License Fee Account in the Transportation Tax Fund, and into the Local Revenue Fund, pursuant to Section 11000 or Section 11000.1, as applicable.

(C) During any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets required by subparagraph (A), within 90 days of a reduction of funding, the department shall reduce the amount of each offset computed pursuant to that subparagraph by multiplying that amount by the ratio of the amount of moneys actually available to be transferred from the General Fund to pay for those offsets to the amount of moneys that is necessary to fully fund those offsets.

(4) (A) For any initial or original registration of any vehicle, never before registered in this state, for which the final due date for the license fee is on or after January 1 of any calendar year for which this paragraph is operative, and for any renewal of registration with an expiration date on or after January 1 of any calendar year for which this paragraph is operative, the department shall offset the total amount of fees otherwise due at the time of registration of that vehicle by an amount equal to 55 percent of the amount computed pursuant to Section 10752 or 10752.1, or Section 18115 of the Health and Safety Code.

(B) Upon proper payment of license fees to the Department of Motor Vehicles, the amount of the offset for each vehicle shall be transferred into the Motor Vehicle License Fee Account in the Transportation Tax Fund, and into the Local Revenue Fund, pursuant to Section 11000 or Section 11000.1, as applicable.

(C) During any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets required by subparagraph (A), within 90 days of a reduction of funding, the department shall reduce the amount of each offset computed pursuant to that subparagraph by multiplying that amount by the ratio of the amount of moneys actually available to be transferred from the General Fund to pay for those offsets to the amount of moneys that is necessary to fully fund those offsets.

(5) (A) For any initial or original registration of any vehicle, never before registered in this state, for which the final due date for the license fee is on or after January 1 of any calendar year for which this paragraph is operative, and for any renewal of registration with

an expiration date on or after January 1 of any calendar year for which this paragraph is operative, the department shall offset the total amount of fees otherwise due at the time of registration of that vehicle by an amount equal to $67^1/_2$ percent of the amount computed pursuant to Section 10752 or 10752.1, or Section 18115 of the Health and Safety Code.

(B) Upon proper payment of license fees to the Department of Motor Vehicles, the amount of the offset for each vehicle shall be transferred into the Motor Vehicle License Fee Account in the Transportation Tax Fund, and into the Local Revenue Fund, pursuant to Section 11000 or Section 11000.1, as applicable.

(C) During any period in which insufficient moneys are available to be transferred from the General Fund to fully fund the offsets required by subparagraph (A), within 90 days of a reduction in funding, the department shall reduce the amount of each offset computed pursuant to that subparagraph by multiplying that amount by the ratio of the amount of moneys actually available to be transferred from the General Fund to pay for those offsets to the amount of moneys that is necessary to fully fund those offsets.

(b) The offset provisions set forth in subdivision (a) shall be operative as provided by the following:

(1) Paragraph (1) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 1999, unless paragraph (2), (3), (4), or (5) of subdivision (a) becomes operative. In that event, paragraph (1) of subdivision (a) will be inoperative only for that period during which one of those paragraphs is operative.

(2) Paragraph (2) of subdivision (a) shall be operative for vehicle license fees with a final due date in the calendar year beginning on January 1, 2001, if the forecast of General Fund revenue, excluding transfers, for the 2000–01 fiscal year, is at least sixty-five billion five hundred twenty-six million dollars ($65,526,000,000). On September 1, 2000, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(3) Paragraph (2) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2002, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2001–02 fiscal year, is at least sixty-eight billion six hundred forty million dollars ($68,640,000,000). On September 1, 2001, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (2) of subdivision (a) became operative pursuant to paragraph (2) of this subdivision.

If paragraph (3), (4), or (5) of subdivision (a) becomes operative for any calendar year beginning on or after January 1, 2002, paragraph (2) of subdivision (a) shall be inoperative during the period in which any of those paragraphs is so operative.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(4) If paragraph (2) of subdivision (a) does not become operative pursuant to paragraph (2) of this subdivision, paragraph (2) of subdivision (a) shall be operative for vehicle license fees with a final due date in the calendar year beginning on January 1, 2002, if the forecast of General Fund revenue, excluding transfers, for the 2001–02 fiscal year, is at least sixty-eight billion six hundred forty million dollars ($68,640,000,000), but is less than sixty-nine billion one hundred forty million dollars ($69,140,000,000). If paragraph (2) of subdivision (a) does not become operative pursuant to paragraph (2) of this subdivision, the Director of Finance shall, on September 1, 2001, certify to the Governor, the Legislature, and the department whether the condition set forth in the preceding sentence has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(5) Paragraph (3) of subdivision (a) shall be operative for vehicle license fees with a final due date in the calendar year beginning on January 1, 2002, if the forecast of General Fund revenue, excluding transfers, for the 2001–02 fiscal year, is at least sixty-nine billion one hundred forty million dollars ($69,140,000,000). On September 1, 2001, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(6) Paragraph (2) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2003, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2002–03 fiscal year, is at least seventy-two billion one hundred sixty million dollars ($72,160,000,000). On September 1, 2002, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (2) of subdivision (a) became operative pursuant to paragraph (4) of this subdivision, or paragraph (3) of subdivision (a) became operative pursuant to paragraph (5) of this subdivision.

If paragraph (3), (4), or (5) of subdivision (a) becomes operative for any calendar year beginning on or after January 1, 2003, paragraph (2) of subdivision (a) shall be inoperative during the period in which any of those paragraphs is so operative.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(7) If paragraph (2) of subdivision (a) does not become operative pursuant to paragraph (6) of this subdivision, paragraph (2) of subdivision (a) shall be operative for vehicle license fees with final due date in the calendar year beginning on January 1, 2003, if the forecast of General Fund revenue, excluding transfers, for the 2002–03 fiscal year, is at least seventy-two billion one hundred sixty million dollars ($72,160,000,000), but is less than seventy-two billion six hundred sixty million dollars ($72,660,000,000). If paragraph (2) of subdivision (a) does not become operative pursuant to paragraph (6) of this subdivision, the Director of Finance shall, on September 1, 2002, certify to the Governor, the Legislature, and the department whether the condition set forth in the preceding sentence has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(8) Paragraph (3) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2003, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2002–03 fiscal year, is at least seventy-two billion one hundred sixty million dollars ($72,160,000,000). On September 1, 2002, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (3) of subdivision (a) became operative pursuant to paragraph (5) of this subdivision.

If paragraph (4) or (5) of subdivision (a) becomes operative for any calendar year beginning on or after January 1, 2003, paragraph (3) of subdivision (a) shall be inoperative during the period in which either of those paragraphs is so operative.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(9) If paragraph (3) of subdivision (a) does not become operative pursuant to paragraph (8) of this subdivision, paragraph (3) of subdivision (a) shall be operative for vehicle license fees with final due date in the calendar year beginning on January 1, 2003, if the forecast of General Fund revenue, excluding transfers, for the 2002–03 fiscal year, is at least seventy-two billion six hundred sixty million dollars ($72,660,000,000), but is less than seventy-three billion one hundred sixty million dollars ($73,160,000,000). If paragraph (3) of subdivision (a) does not become operative pursuant to paragraph (8) of this subdivision, the Director of Finance shall, on September 1, 2002, certify to the Governor, the Legislature, and the department whether the condition set forth in the preceding sentence has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(10) Paragraph (4) of subdivision (a) shall be operative for vehicle license fees with a final due date in the calendar year beginning on January 1, 2003, if the forecast of General Fund revenue, excluding transfers, for the 2002–03 fiscal year, is at least seventy-three billion one hundred sixty million dollars ($73,160,000,000) but is less than seventy-four billion three hundred sixty million dollars ($74,360,000,000). On September 1, 2002, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(11) Paragraph (5) of subdivision (a) shall be operative for vehicle license fees with a final due date in the calendar year beginning on January 1, 2003, if the forecast of General Fund revenue, excluding transfers, for the 2002–03 fiscal year, is at least seventy-four billion three hundred sixty million dollars ($74,360,000,000). On September 1, 2002, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(12) Paragraph (2) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2004, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2003–04 fiscal year, is at least seventy-six billion one hundred

eight million dollars ($76,108,000,000). On September 1, 2003, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (2) of subdivision (a) became operative pursuant to paragraph (7) of this subdivision, paragraph (3) of subdivision (a) became operative pursuant to paragraph (9) of this subdivision, paragraph (4) of subdivision (a) became operative pursuant to paragraph (10) of this subdivision, or paragraph (5) of subdivision (a) became operative pursuant to paragraph (11) of this subdivision.

If paragraph (3), (4), or (5) of subdivision (a) becomes operative for any calendar year beginning on or after January 1, 2004, paragraph (2) of subdivision (a) shall become inoperative.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(13) Paragraph (3) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2004, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2003–04 fiscal year, is at least seventy-six billion one hundred eight million dollars ($76,108,000,000). On September 1, 2003, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (3) of subdivision (a) became operative pursuant to paragraph (9) of this subdivision, paragraph (4) of subdivision (a) became operative pursuant to paragraph (10) of this subdivision, or paragraph (5) of subdivision (a) became operative pursuant to paragraph (11) of this subdivision.

If paragraph (4) or (5) of subdivision (a) becomes operative for the calendar year beginning on or after January 1, 2004, paragraph (3) of subdivision (a) shall become inoperative.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(14) Paragraph (4) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2004, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2003–04 fiscal year, is at least seventy-seven billion one hundred eight million dollars ($77,108,000,000). On September 1, 2003, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (4) of subdivision (a) became operative pursuant to paragraph (10) of this subdivision, or paragraph (5) of subdivision (a) became operative pursuant to paragraph (11) of this subdivision.

If paragraph (5) of subdivision (a) becomes operative for the calendar year beginning on or after January 1, 2004, paragraph (4) of subdivision (a) shall become inoperative.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(15) Paragraph (5) of subdivision (a) shall be operative for vehicle license fees with a final due date in each calendar year beginning on or after January 1, 2004, if both of the following occur:

(A) The forecast of General Fund revenue, excluding transfers, for the 2003–04 fiscal year, is at least seventy-eight billion three hundred eight million dollars ($78,308,000,000). On September 1, 2003, the Director of Finance shall certify to the Governor, the Legislature, and the department whether this condition has been met.

(B) Paragraph (5) of subdivision (a) became operative pursuant to paragraph (11) of this subdivision.

Five days before certification, the Director of Finance shall submit to the Chair of the Joint Legislative Budget Committee a forecast of General Fund revenues with sufficient detail to document the basis of the certification.

(c) (1) For purposes of this section, ‘‘department’’ means the Department of Motor Vehicles and the Department of Housing and Community Development.

(2) For purposes of this section, the ‘‘final due date’’ for a license fee is the last date upon which that fee may be paid without being delinquent.

(3) For purposes of certifications specified in paragraphs (2) to (15), inclusive, of subdivision (b), the General Fund revenue forecast, excluding transfers, that is used for the enactment of the relevant budget act shall be calculated in a manner that is consistent with the definition of General Fund revenues, excluding transfers, that was used by the Department of Finance in the 1998 May Revision revenue forecast as reflected on Schedule 8 of that revision.

(4) For purposes of making the certifications specified in paragraphs (2) to (15), inclusive, of subdivision (b), the Department of Finance shall, for each of the 2000–01 to 2003–04 fiscal years, inclusive, estimate the combined fiscal impact of all state tax law changes, including any changes with respect to interest or penalties, that were enacted by the Legislature and signed by the Governor on or after January 1, 1999. If for any fiscal year, the Department of Finance estimates a cumulative reduction in General Fund revenues in excess of one hundred million dollars ($100,000,000), the

Department of Finance shall subtract the amount of that estimated reduction from each of the General Fund revenue target amounts, specified in paragraphs (2) to (15), inclusive, of subdivision (b), and shall apply each resulting difference in lieu of each corresponding target amount. For each fiscal year for which the preceding sentence applies, the Department of Finance shall also do all of the following:

(A) Subtract the amount of the estimated General Fund revenue loss from the estimated amount of the fiscal impact of each offset specified in paragraphs (2) to (5), inclusive, of subdivision (a).

(B) Divide each annual amount calculated pursuant to subparagraph (A) by the corresponding estimate by the Department of Finance of annual vehicle license fee revenues.

(C) Calculate percentages by multiplying each quotient determined pursuant to subparagraph (B) by 100 and rounding each result to the nearest 10th.

(D) Provide the percentages calculated in subparagraph (C) to the department, which shall apply those percentages in lieu of those corresponding offsets set forth in paragraphs (2) to (5), inclusive, of subdivision (a).

(5) For purposes of making the certifications specified in paragraphs (2) to (15), inclusive, of subdivision (b), the Department of Finance shall do all of the following:

(A) Estimate for each of the 2000–01 to 2003–04 fiscal years, inclusive, the total fiscal impact of all settlements that result in an annual revenue increase of more than one hundred million dollars ($100,000,000) per year for five fiscal years or less.

(B) Subtract each total fiscal impact estimated pursuant to subparagraph (A) from the amounts of the revenue forecasts referred to in paragraphs (2) to (15), inclusive, of subdivision (b).

(C) Use each difference calculated pursuant to subparagraph (B) in lieu of each corresponding revenue forecast.

SEC. 3. Section 10759 of the Revenue and Taxation Code is amended to read:

10759. In computing any fee, offset, or penalty imposed by this chapter, whether on a proration or otherwise, a fraction of a dollar is disregarded, unless it equals or exceeds fifty cents ($0.50), in which case it is treated as one full dollar ($1). Computation of any penalty shall be made from the fee after the same has been computed as provided in this section.

Any fee, offset, or penalty in an amount of forty-nine cents ($0.49) or less shall be deemed to be one dollar ($1).

SEC. 4. Section 10901 of the Revenue and Taxation Code is amended to read:

10901. Whenever the department or the Department of Housing and Community Development erroneously collects any license fee or portion of a fee not required to be paid under this part, or erroneously applies any offset provided under this part, the

erroneously collected amount shall be refunded to the person paying it upon application therefor made within three years after the date of the payment. If the department or the Department of Housing and Community Development discovers an error, it may make a refund in the absence of an application therefor.

SEC. 5. Section 10902 of the Revenue and Taxation Code is amended to read:

10902. (a) In the event of a constructive total loss, in which the repair value exceeds the market value of the vehicle less the anticipated salvage value, or a nonrepairable vehicle, or an unrecovered total loss, due to a theft, of a vehicle, the in-lieu fee portion of the vehicle license fee that has been paid, less any offset provided in Section 10754, shall be refunded to the current registered owner (the owner of the salvage value of the vehicle), or credited against the vehicle license fee owed on the owner's replacement vehicle. The amount refunded or credited shall be based upon one-twelfth of the annual in-lieu fee, less any offset provided by Section 10754, for each full month that remains until the registration expires.

(b) No refund or credit shall be made pursuant to this section unless the vehicle owner has signed a declaration under penalty of perjury that he or she has not been cited or convicted of violating Section 23152 or 23153 of the Vehicle Code (relating to driving under the influence of alcohol or drugs) or Section 23103 as specified in Section 23103.5 of that code (which involves a substitute for an original citation of driving under the influence) in connection with the owner's vehicle loss. If the owner has been cited under any of these code sections, the owner shall be entitled to the refund or credit upon presentation of either proof of dismissal of the citation or a finding of not guilty.

(c) The Department of Motor Vehicles may charge to vehicle owners requesting a refund or credit pursuant to this section a fee in an amount sufficient to cover the administrative costs of processing the request.

(d) In the case of a request for refund or credit with respect to a stolen vehicle, the vehicle owner shall not be entitled to a refund or credit prior to 60 days from the date the theft of the vehicle is reported to the police. If a refund is received or a credit is applied to another vehicle and the stolen vehicle is subsequently recovered, the owner shall return the amount refunded or credited. If the owner receives a refund or credit, and the destroyed or stolen vehicle is scrapped and subsequently repaired by another person, the new owner shall pay the full vehicle license fee.

(e) The Department of Motor Vehicles shall adopt regulations for the administration of the refunds and credits provided by this section.

SEC. 6. Section 11000 is added to the Revenue and Taxation Code, immediately following the heading of Chapter 5 (commencing with Section 11001) of Part 5 of Division 2, to read:

11000. (a) Beginning on the operative date of Section 9551.2 of the Vehicle Code, the Controller shall do both of the following:

(1) Transfer from the General Fund to the Motor Vehicle License Fee Account in the Transportation Tax Fund an amount equal to 75.67 percent of the amount of offsets that are applied by the department pursuant to Sections 9551.2 and 9554.1 of the Vehicle Code.

(2) Transfer from the General Fund to the Local Revenue Fund, established pursuant to Section 17600 of the Welfare and Institutions Code, in the Transportation Tax Fund an amount equal to 24.33 percent of the amount of offsets that are applied by the department pursuant to Sections 9551.2 and 9554.1 of the Vehicle Code.

(b) The department shall notify the Controller of the total amount of the offsets applied by the department pursuant to Section 9551.2 of the Vehicle Code concurrently with the department's transfer for deposit of vehicle license fee revenues as required by law.

(c) For purposes of Section 15 of Article XI of the California Constitution, the General Fund revenues that are transferred as required by paragraph (1) of subdivision (a) shall constitute successor tax revenues to the vehicle license fees offset in this part and shall be allocated in the same manner as revenue derived from taxes imposed pursuant to this part.

(d) For purposes of Article 1 (commencing with Section 25350) of Chapter 5 of Part 2 of Division 2 of Title 3 of the Government Code, Section 11003, and Chapter 6 (commencing with Section 17600) of Part 5 of Division 9 of the Welfare and Institutions Code, the General Fund transfer amounts specified in paragraphs (1) and (2) of subdivision (a) are hereby deemed to be vehicle license fee proceeds and vehicle license fee revenues. These General Fund transfer amounts are subject to the same pledges, liens and encumbrances, and priorities set forth in Section 25350 and following of, Section 53584 and following of, and Section 5450 and following of, the Government Code.

(e) Nothing in this section amends or intends to amend or impair Section 25350 and following of, Section 53584 and following of, the Government Code, or any other statute dealing with the interception of funds.

SEC. 7. Section 11000.1 is added to the Revenue and Taxation Code, to read:

11000.1. (a) The Controller shall do both of the following:

(1) Transfer from the General Fund to the Motor Vehicle License Fee Account in the Transportation Tax Fund, in accordance with the information received from the department pursuant to subdivision (b), an amount that is equal to 75.67 percent of the offsets that are

determined by the department to be subject to Sections 9551.1 and 9554.1 of the Vehicle Code.

(2) Transfer from the General Fund to the Local Revenue Fund, in accordance with the information received from the department pursuant to subdivision (b), an amount that is equal to 24.33 percent of the offsets that are determined by the department to be subject to Sections 9551.1 and 9554.1 of the Vehicle Code.

(b) For purposes of transfers by the Controller pursuant to paragraphs (1) and (2) of subdivision (a), the department shall provide the Controller with daily estimates of the amounts required to be transferred pursuant to each of those paragraphs, and shall, no less frequently than monthly, notify the Controller of amounts of adjustments to those estimates that reflect completed registrations. On or before June 30, 1999, the department shall notify the Controller of the amounts of any additional adjustments to General Fund transfers required by each of those paragraphs that are required to accurately reflect the total amount of offsets that are subject to Section 9551.1 of the Vehicle Code.

(c) For purposes of Section 15 of Article XI of the California Constitution, the General Fund revenues that are transferred as required by paragraph (1) of subdivision (a) shall be allocated in the same manner as revenue derived from taxes imposed pursuant to this part.

(d) For purposes of Article 1 (commencing with Section 25350) of Chapter 5 of Part 2 of Division 2 of Title 3 of the Government Code, Section 11003, and Chapter 6 (commencing with Section 17600) of Part 5 of Division 9 of the Welfare and Institutions Code, the General Fund transfer amounts specified in paragraphs (1) and (2) of subdivision (a) are hereby deemed to be vehicle license fee proceeds and vehicle license fee revenues. These General Fund transfer amounts are subject to the same pledges, liens and encumbrances, and priorities set forth in Section 25350 and following of, Section 53584 and following of, and Section 5450 and following of, the Government Code.

(e) (1) This section does not apply to transfers from the General Fund with respect to any offsets that are subject to Section 9551.2 of the Vehicle Code.

(2) Nothing in the act adding this section amends or intends to amend or impair Section 25350 and following of, or Section 53584 and following of, the Government Code, or any other statute dealing with the interception of funds.

(f) This section is repealed on January 1, 2000.

SEC. 8. 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	January 1, 1998

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

(3) Subtitle G (Tax Technical Corrections) and Part I of Subtitle H (Repeal of Expired or Obsolete Provisions) of the Revenue Reconciliation Act of 1990 (Public Law 101-508) modified numerous provisions of the Internal Revenue Code and provisions of prior federal acts, some of which are incorporated by reference into this part. Unless otherwise provided, the provisions described in the preceding sentence, to the extent that they modify provisions that are incorporated into this part, are declaratory of existing law and shall be applied in the same manner and for the same periods as specified in the Revenue Reconciliation Act of 1990.

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

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

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

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

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

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

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

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

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

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

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

(11) Nonresident aliens.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

SEC. 9. Section 17052.25 of the Revenue and Taxation Code is amended to read:

17052.25. (a) For each taxable year beginning on or after January 1, 1994, there shall be allowed as a credit against the ''net tax,'' as defined in Section 17039, an amount equal to 50 percent of the costs paid or incurred by a taxpayer for the adoption of any minor child who is a citizen or legal resident of the United States and was in the custody of a public agency of either this state or a political subdivision of this state. The credit shall not exceed two thousand five hundred dollars ($2,500) per minor child.

(b) ''Costs'' eligible for the credit pursuant to subdivision (a) shall include the following:

(1) Fees for required services of either the Department of Social Services or a licensed adoption agency.

(2) Travel and related expenses for the adoptive family that are directly related to the adoption process.

(3) Medical fees and expenses that are not reimbursed by insurance and are directly related to the adoption process.

(c) The credit authorized by this section shall be claimed for the taxable year in which the decree or order of adoption is entered pursuant to Section 8612 of the Family Code. However, the allowable credit claimed may include any costs of that adoption paid or incurred in any prior taxable year.

(d) 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 succeeding years if necessary, until the total credit of two thousand five hundred dollars ($2,500) per minor child is exhausted.

(e) Any deduction otherwise allowed under this part for any amount paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit allowed under this section.

SEC. 10. Section 17053.36 is added to the Revenue and Taxation Code, to read:

17053.36. (a) For each taxable year beginning on or after January 1, 2001, and before January 1, 2006, a qualified taxpayer shall be allowed as a credit against the ‘‘net tax,’’ as defined in Section 17039, an amount equal to the following:

(1) Fifty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2001, and before January 1, 2002.

(2) Forty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2002, and before January 1, 2003.

(3) Thirty percent of the qualified wages paid or incurred during any taxable year beginning on or after January 1, 2003, and before January 1, 2004.

(4) Twenty percent of the qualified wages paid or incurred during any taxable year beginning on or after January 1, 2004, and before January 1, 2005.

(5) Ten percent of the qualified wages paid or incurred during any taxable year beginning on or after January 1, 2005, and before January 1, 2006.

(b) For purposes of this section:

(1) (A) ‘‘Qualified taxpayer’’ means any taxpayer under an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter.

(B) In the case of any pass-through entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23636 shall be allowed to the pass-through entity and passed through to the partners or shareholders in accordance with applicable provisions of this part or Part 11 (commencing with Section 23001). For purposes of this paragraph, ‘‘pass-through entity’’ means any partnership or S corporation.

(2) ‘‘Qualified wages’’ means that portion of wages paid or incurred by the qualified taxpayer during the taxable year with respect to qualified employees that are direct costs as defined in Section 263A of the Internal Revenue Code allocable to property manufactured in this state by the qualified taxpayer for ultimate use in a Joint Strike Fighter.

(3) ‘‘Qualified employee’’ means an individual whose services for the qualified taxpayer are performed in this state and are at least 90 percent directly related to the qualified taxpayer’s contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter.

(4) ‘‘Joint Strike Fighter’’ means the next generation air combat strike aircraft developed and produced under the Joint Strike Fighter program.

(5) ‘‘Joint Strike Fighter program’’ means the multiservice, multinational project conducted by the United States government to

develop and produce the next generation of air combat strike aircraft.

(c) The credit allowed by this section shall not exceed ten thousand dollars ($10,000) per year, per qualified employee. For employees that are qualified employees for part of a taxable year, the credit shall not exceed ten thousand dollars ($10,000) multiplied by a fraction, the numerator of which is the number of months of the taxable year that the employee is a qualified employee and the denominator of which is 12.

(d) 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 seven succeeding years if necessary, until the credit is exhausted.

(e) No credit shall be allowed unless the credit is reflected within the bid upon which the qualified taxpayer's contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter is based by reducing the amount of the bid by the amount of the credit allowable.

(f) All references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a contract or subcontract and for which a qualified taxpayer is making a claim shall be made available to the Franchise Tax Board upon request.

(g) This section shall remain in effect only until December 1, 2006, and as of that date is repealed.

SEC. 11. Section 17053.37 is added to the Revenue and Taxation Code, to read:

17053.37. (a) For each taxable year beginning on or after January 1, 2001, and before January 1, 2006, a qualified taxpayer shall be allowed as a credit against the ''net tax,'' as defined in Section 17039, an amount equal to 10 percent of the qualified cost of qualified property that is placed in service in this state.

(b) (1) For purposes of this section, ''qualified cost'' means any costs that satisfy each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2001, and before January 1, 2006. In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or before January 1, 2001, costs paid pursuant to that contract shall be subject to allocation as follows. Contract costs shall be allocated to qualified property based on a ratio of costs actually paid prior to January 1, 2001, and total contract costs actually paid. ''Cost paid'' shall include, without limitation, contractual deposits and option payments. To the extent of costs allocated, whether or not currently deductible or depreciable

for tax purposes, to a period prior to January 1, 2001, the cost shall be deemed allocated to property acquired before January 1, 2001, and is thus not a ''qualified cost.''

(B) Except as provided in paragraph (2) of subdivision (d), is an amount upon which the qualified taxpayer has paid, directly or indirectly, as a separately stated contract amount or as determined from the records of the qualified taxpayer, sales or use tax under Part 1 (commencing with Section 6001).

(C) Is an amount properly chargeable to the capital account of the qualified taxpayer.

(2) (A) For purposes of this subdivision, any contract entered into on or after January 1, 2001, that is a successor or replacement contract to a contract that was binding before January 1, 2001, shall be treated as a binding contract in existence before January 1, 2001.

(B) If a successor or replacement contract is entered into on or after January 1, 2001, and the subject of the successor or replacement contract relates both to amounts for the construction, reconstruction, or acquisition of qualified property described in the original binding contract and to costs for the construction, reconstruction, or acquisition of qualified property not described in the original binding contract, then the portion of those amounts described in the successor or replacement contract that were not described in the original binding contract shall not be treated as costs paid or incurred pursuant to a binding contract in existence on or prior to January 1, 2001, under subparagraph (A) of paragraph (1).

(3) (A) For purposes of this section, an option contract in existence before January 1, 2001, under which a qualified taxpayer (or any other person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) had an option to acquire qualified property, shall be treated as a binding contract under the rules in paragraph (2). For purposes of this subparagraph, an option contract shall not include an option under which the optionholder will forfeit an amount less than 10 percent of the fixed option price in the event the option is not exercised.

(B) For purposes of this section, a contract shall be treated as binding even if the contract is subject to a condition.

(c) (1) For purposes of this section, ''qualified taxpayer'' means any taxpayer under an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter.

(2) In the case of any pass-through entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23637 shall be allowed to the pass-through entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph,

the term ‘‘pass-through entity’’ means any partnership or S corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) (1) For purposes of this section, ‘‘qualified property’’ means property that is described as either of the following:

(A) Tangible personal property that is defined in Section 1245(a)(3)(A) of the Internal Revenue Code for use by a qualified taxpayer primarily in qualified activities to manufacture a product for ultimate use in a Joint Strike Fighter.

(B) The value of any capitalized labor costs that are direct costs as defined in Section 263A of the Internal Revenue Code allocable to the construction or modification of property described in subparagraph (A).

(2) Qualified property does not include any of the following:

(A) Furniture.

(B) Inventory.

(C) Equipment used to store finished products that have completed the manufacturing process.

(D) Any tangible personal property that is used in administration, general management, or marketing.

(e) For purposes of this section:

(1) ‘‘Fabricating’’ means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(2) ‘‘Joint Strike Fighter’’ means the next generation air combat strike aircraft developed and produced under the Joint Strike Fighter program.

(3) ‘‘Joint Strike Fighter program’’ means the multiservice, multinational project conducted by the United States government to develop and produce the next generation of air combat strike aircraft.

(4) ‘‘Manufacturing’’ means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate use in a Joint Strike Fighter. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(5) ‘‘Primarily’’ means tangible personal property used 50 percent or more of the time in an activity described in subparagraph (A) of paragraph (1) of subdivision (d).

(6) ‘‘Process’’ means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, or fabricating

activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, or fabricating activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer's manufacturing, processing, or fabricating activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer's manufacturing, processing, or fabricating activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, or fabricating process.

(7) ''Processing'' means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) ''Qualified activities'' means manufacturing, processing, or fabricating of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, or fabricating has altered tangible personal property to its completed form, including packaging, if required.

(f) The credit allowed under subdivision (a) shall apply to qualified property that is acquired by or subject to lease by a qualified taxpayer, subject to the following special rules:

(1) A lessor of qualified property, irrespective of whether the lessor is a qualified taxpayer, shall not be allowed the credit provided under subdivision (a) with respect to any qualified property leased to another qualified taxpayer.

(2) For purposes of paragraphs (2) and (3) of subdivision (b), ''binding contract'' includes any lease agreement with respect to the qualified property.

(3) (A) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is not treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(i) Except as provided by subparagraph (C) of this paragraph, subparagraphs (A) and (C) of paragraph (1) of subdivision (b) shall not apply.

(ii) Except as provided in subparagraph (B) and clause (iii), the ''qualified cost'' upon which the lessee shall compute the credit provided under this section shall be equal to the original cost to the lessor (within the meaning of Section 18031) of the qualified property that is the subject of the lease.

(iii) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied only if the lessor has made a timely election under either Section 6094.1 or subdivision (d) of Section 6244 and has paid sales tax reimbursement or use tax

measured by the purchase price of the qualified property (within the meaning of paragraph (5) of subdivision (g) of Section 6006). For purposes of this subdivision, the amount of original cost to the lessor which may be taken into account under clause (ii) shall not exceed the purchase price upon which sales tax reimbursement or use tax has been paid under the preceding sentence.

(B) For purposes of applying subparagraph (A) only, the following special rules shall apply:

(i) The original cost to the lessor of the qualified property shall be reduced by the amount of any original cost of that property that was taken into account by a predecessor lessee in computing the credit allowable under this section.

(ii) Clause (i) shall not apply in any case where the predecessor lessee was required to recapture the credit provided under this section pursuant to the provisions of subdivision (g).

(iii) For purposes of this section only, in any case where a successor lessor has acquired qualified property from a predecessor lessor in a transaction not treated as a sale under Part 1 (commencing with Section 6001), the original cost to the successor lessor of the qualified property shall be reduced by the amount of the original cost of the qualified property that was taken into account by any lessee of the predecessor lessor in computing the credit allowable under this section.

(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 2001, and before January 1, 2006, shall be taken into account. In the case of any qualified property constructed, reconstructed, or acquired by a lessor pursuant to a binding contract in existence on or prior to January 1, 2001, the allocation rule specified in subparagraph (A) of paragraph (1) of subdivision (b) shall apply in determining the original cost to the lessor of qualified property.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any party related to the lessee within the meaning of Section 267 or 318 of the Internal Revenue Code) acquires the qualified property from the lessor (or any successor lessor) within one year from the date the qualified property is first used by the lessee under the terms of the lease, the lessee's (or related party's) acquisition of the qualified property from the lessor (or successor lessor) shall be treated as a disposition by the lessee of the qualified property that was subject to the lease under subdivision (g).

(4) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(A) Subparagraph (A) of paragraph (1) of subdivision (b) shall be applied by substituting the term ‘‘purchase’’ for the term ‘‘construction, reconstruction, or acquisition.’’

(B) Subparagraph (C) of paragraph (1) of subdivision (b) shall apply.

(C) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied at the time that either the lessor or the qualified taxpayer pays sales or use tax under Part 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor’s original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee’s taxable year in which the credit is allowable to the lessee under this section.

(B) The statement required under subparagraph (A) shall be made available to the Franchise Tax Board upon request.

(g) No credit shall be allowed if the qualified property is removed from the state, is disposed of to an unrelated party, or is used for any purpose not qualifying for the credit provided in this section in the same taxable year in which the taxpayer first places the qualified property in service in this state. If any qualified property for which a credit is allowed pursuant to this section is thereafter removed from this state, disposed of to an unrelated party, or used for any purpose not qualifying for the credit provided in this section within one year from the date the taxpayer first places the qualified property in service in this state, the amount of the credit allowed by this section for that qualified property shall be recaptured by adding that credit amount to the net tax of the qualified taxpayer for the taxable year in which the qualified property is disposed of, removed, or put to an ineligible use.

(h) 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 seven succeeding years if necessary, until the credit is exhausted.

(i) (1) No credit shall be allowed under this section if a credit is claimed under Section 17053.49 in connection with the same property.

(2) No credit shall be allowed unless the credit is reflected within the bid upon which the qualified taxpayer’s contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter is based by reducing the amount of the bid by the amount of the credit allowable.

(j) All references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a contract or subcontract and for which a qualified taxpayer is making a claim shall be made available to the Franchise Tax Board upon request.

(k) This section shall remain in effect only until December 1, 2006, and as of that date is repealed.

SEC. 12. Section 17053.5 of the Revenue and Taxation Code is amended to read:

17053.5. (a) (1) For a qualified renter, there shall be allowed a credit against his or her ''net tax'' (as defined in Section 17039). The amount of the credit shall be as follows:

(A) For married couples filing joint returns, heads of household and surviving spouses (as defined in Section 17046) the credit shall be equal to one hundred twenty dollars ($120) if adjusted gross income is fifty thousand dollars ($50,000) or less.

(B) For other individuals, the credit shall be equal to sixty dollars ($60) if adjusted gross income is twenty-five thousand dollars ($25,000) or less.

(2) Except as provided in subdivision (b), a husband and wife shall receive but one credit under this section. If the husband and wife file separate returns, the credit may be taken by either or equally divided between them, except as follows:

(A) If one spouse was a resident for the entire taxable year and the other spouse was a nonresident for part or all of the taxable year, the resident spouse shall be allowed one-half the credit allowed to married persons and the nonresident spouse shall be permitted one-half the credit allowed to married persons, prorated as provided in subdivision (e).

(B) If both spouses were nonresidents for part of the taxable year, the credit allowed to married persons shall be divided equally between them subject to the proration provided in subdivision (e).

(b) For a husband and wife, if each spouse maintained a separate place of residence and resided in this state during the entire taxable year, each spouse will be allowed one-half the full credit allowed to married persons provided in subdivision (a).

(c) For purposes of this section, a ''qualified renter'' means an individual who:

(1) Was a resident of this state, as defined in Section 17014, and

(2) Rented and occupied premises in this state which constituted his or her principal place of residence during at least 50 percent of the taxable year.

(d) The term ''qualified renter'' does not include any of the following:

(1) An individual who for more than 50 percent of the taxable year rented and occupied premises that were exempt from property taxes, except that an individual, otherwise qualified, is deemed a qualified renter if he or she or his or her landlord pays possessory interest taxes, or the owner of those premises makes payments in lieu of property taxes that are substantially equivalent to property taxes paid on properties of comparable market value.

(2) An individual whose principal place of residence for more than 50 percent of the taxable year is with any other person who claimed such individual as a dependent for income tax purposes.

(3) An individual who has been granted or whose spouse has been granted the homeowners' property tax exemption during the taxable year. This paragraph does not apply to an individual whose spouse has been granted the homeowners' property tax exemption if each spouse maintained a separate residence for the entire taxable year.

(e) Any otherwise qualified renter who is a nonresident for any portion of the taxable year shall claim the credits set forth in subdivision (a) at the rate of one-twelfth of those credits for each full month that individual resided within this state during the taxable year.

(f) Every person claiming the credit provided in this section shall, as part of that claim, and under penalty of perjury, furnish that information as the Franchise Tax Board prescribes on a form supplied by the board.

(g) The credit provided in this section shall be claimed on returns in the form as the Franchise Tax Board may from time to time prescribe.

(h) For the purposes of this section, the term ''premises'' means a house or a dwelling unit used to provide living accommodations in a building or structure and the land incidental thereto, but does not include land only, unless the dwelling unit is a mobilehome. The credit is not allowed for any taxable year for the rental of land upon which a mobilehome is located if the mobilehome has been granted a homeowners' exemption under Section 218 in that year.

(i) For qualified renters whose credits provided in this section exceed their tax liability computed under this part the excess shall be credited against other amounts due, if any, from the qualified renter .

(j) This section shall become operative on January 1, 1998, and applies to any taxable year beginning on or after January 1, 1998.

(k) For each taxable year beginning on or after January 1, 1999, the Franchise Tax Board shall recompute the adjusted gross income amounts set forth in subdivision (a). That computation shall be made as follows:

(1) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current year, no later than August 1 of the current calendar year.

(2) The Franchise Tax Board shall compute an inflation adjustment factor by adding 100 percent to that portion of the percentage change figure which is furnished pursuant to paragraph (1) and dividing the result by 100.

(3) The Franchise Tax Board shall multiply the amount in subparagraph (B) of paragraph (1) of subdivision (d) for the preceding taxable year by the inflation adjustment factor determined in paragraph (2), and round off the resulting products to the nearest one dollar ($1).

(4) In computing the amounts pursuant to this subdivision, the amounts provided in subparagraph (A) of paragraph (1) of subdivision (a) shall be twice the amount provided in subparagraph (B) of paragraph (1) of subdivision (a).

SEC. 13. Section 17054 of the Revenue and Taxation Code is amended to read:

17054. In the case of individuals, the following credits for personal exemption may be deducted from the tax imposed under Section 17041 or 17048, less any increases imposed under paragraph (1) of subdivision (d) or paragraph (1) of subdivision (e), or both, of Section 17560.

(a) In the case of a single individual, a head of household, or a married individual making a separate return, a credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988.

(b) In the case of a surviving spouse (as defined in Section 17046), or a husband and wife making a joint return, a credit of one hundred two dollars ($102) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and one hundred four dollars ($104) for taxable years beginning on or after January 1, 1988. If one spouse was a resident for the entire taxable year and the other spouse was a nonresident for all or any portion of the taxable year, the personal exemption shall be divided equally.

(c) In addition to any other credit provided in this section, in the case of an individual who is 65 years of age or over by the end of the taxable year, a credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988.

(d) (1) A credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, and before January 1, 1998, two hundred fifty-three dollars ($253) for taxable years beginning on or after January 1, 1998, and before January 1, 1999, and two hundred twenty-seven dollars ($227) for taxable years beginning on or after January 1, 1999, for each dependent (as defined in Section 17056) for whom an exemption is allowable under Section 151(c) of the Internal Revenue Code, relating to additional exemption for dependents. The credit allowed under this subdivision for taxable years beginning on or after January

1, 1999, shall not be adjusted pursuant to subdivision (i) for any taxable year beginning before January 1, 2000.

(2) The credit allowed under paragraph (1) shall not be denied on the basis that the identification number of the dependent, as defined in Section 17056, for whom an exemption is allowable under Section 151(c) of the Internal Revenue Code, relating to additional exemption for dependents, is not included on the return claiming the credit.

(e) A credit for personal exemption of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, for the taxpayer if he or she is blind at the end of his or her taxable year.

(f) A credit for personal exemption of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(g) For the purposes of this section, an individual is blind only if either: his or her central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or his or her visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

(h) In the case of an individual with respect to whom a credit under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the credit amount applicable to that individual for that individual's taxable year shall be zero.

(i) For each taxable year beginning on or after January 1, 1989, the Franchise Tax Board shall compute the credits prescribed in this section. That computation shall be made as follows:

(1) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index as modified for rental equivalent homeownership for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(2) The Franchise Tax Board shall add 100 percent to the percentage change figure which is furnished to them pursuant to paragraph (1), and divide the result by 100.

(3) The Franchise Tax Board shall multiply the immediately preceding taxable year credits by the inflation adjustment factor

determined in paragraph (2), and round off the resulting products to the nearest one dollar ($1).

(4) In computing the credits pursuant to this subdivision, the credit provided in subdivision (b) shall be twice the credit provided in subdivision (a).

(j) The amendments made to this section by the act adding this subdivision shall be applied only in the computation of taxes for taxable years beginning on or after January 1, 1990.

SEC. 14. Section 17062 of the Revenue and Taxation Code, as amended by Chapter 7 of the Statutes of 1998, is amended to read:

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

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

(2) The regular tax for the taxable year.

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

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

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

(3) (A) The provisions of Section 55(b)(1) of the Internal Revenue Code shall be modified to provide that the tentative minimum tax for the taxable year shall be equal to the following percent of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount, before reduction for any credits against the tax:

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

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

(B) In the case of a nonresident or part-year resident, the tentative minimum tax shall be computed as if the nonresident or part-year resident were a resident for the entire year multiplied by the ratio of California adjusted gross income (as modified for purposes of this chapter) to total adjusted gross income from all sources (as modified for purposes of this chapter). For purposes of computing the tax under subparagraph (A) and gross income from all sources, the net operating loss deduction provided in Section 56(d) of the Internal Revenue Code shall be computed as if the taxpayer were a resident for all prior years.

(C) For purposes of this section, the term ‘‘California adjusted gross income’’ includes each of the following:

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

(ii) For any period during which the taxpayer was not a resident of this state, only those items of adjusted gross income (as modified for purposes of this chapter) which were derived from sources within this state, determined in accordance with Chapter 11 (commencing with Section 17951).

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

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

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

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

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

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

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

(i) In the case of a passthrough entity which reports a profit for the taxable or income year, the taxpayer’s profit interest in the entity at the end of the taxpayer’s taxable year.

(ii) In the case of a passthrough entity which reports a loss for the taxable or income year, the taxpayer’s loss interest in the entity at the end of the taxpayer’s taxable year.

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

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

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

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

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

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

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

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

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

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

(i) A joint return.

(ii) A surviving spouse.

(B) Forty-two thousand nine hundred forty-five dollars ($42,945) in the case of an individual who is both of the following:

(i) Not a married individual.

(ii) Not a surviving spouse.

(C) Twenty-eight thousand six hundred thirty dollars ($28,630) in the case of either of the following:

(i) A married individual who files a separate return.

(ii) An estate or trust.

(6) For taxable years beginning on or after January 1, 1998, Section 55(d)(3) of the Internal Revenue Code, relating to the phaseout of exemption amount for taxpayers other than corporations is modified, for purposes of this part, to provide the following phaseout of exemption amounts in lieu of those contained therein:

(A) Two hundred fourteen thousand seven hundred twenty-five dollars ($214,725) in the case of a taxpayer described in subparagraph (A) of paragraph (5).

(B) One hundred sixty-one thousand forty-four dollars ($161,044) in the case of a taxpayer described in subparagraph (B) of paragraph (5).

(C) One hundred seven thousand three hundred sixty-two dollars ($107,362) in the case of a taxpayer described in subparagraph (C) of paragraph (5).

(7) For each taxable year beginning on or after January 1, 1999, the Franchise Tax Board shall recompute the exemption amounts prescribed in paragraph (5) and the phaseout of exemption amounts prescribed in paragraph (6). Those computations shall be made as follows:

(A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(B) The Franchise Tax Board shall do both of the following:

(i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and dividing the result by 100.

(ii) Multiply the preceding taxable year exemption amounts and the phaseout of exemption amounts by the inflation adjustment factor determined in clause (i) and round off the resulting products to the nearest one dollar ($1).

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

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

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

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

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

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

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

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

(e) (1) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference the amount by which the deduction allowable under Section 170 of the Internal Revenue Code, relating to charitable contributions or gifts, or Section 642(c) of the Internal Revenue Code, relating to deduction for amounts paid or permanently set aside for a charitable purpose, would be reduced if all capital gain property were taken into account at its adjusted basis.

(2) For purposes of paragraph (1), the term ‘‘capital gain property’’ has the meaning given to that term by Section 170(b)(1)(C)(iv) of the Internal Revenue Code. That term shall not include any property to which an election under Section 170(b)(1)(C)(iii) of the Internal Revenue Code applies.

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

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

SEC. 15. Section 17062.5 is added to the Revenue and Taxation Code, to read:

17062.5. Section 55(b)(3) of the Internal Revenue Code, relating to maximum rate of tax on net capital gain of noncorporate taxpayers, shall not apply.

SEC. 16. Section 17073.5 of the Revenue and Taxation Code is amended to read:

17073.5. (a) A taxpayer may elect to take a standard deduction as follows:

(1) In the case of a taxpayer, other than a head of a household or a surviving spouse (as defined in Section 17046) or a married couple filing a joint return, the standard deduction shall be one thousand eight hundred eighty dollars ($1,880).

(2) In the case of a head of household or a surviving spouse (as defined in Section 17046) or a married couple filing a joint return, the standard deduction shall be three thousand seven hundred sixty dollars ($3,760).

(b) The standard deduction provided for in subdivision (a) shall be in lieu of all deductions other than those which are to be subtracted from gross income in computing adjusted gross income under Section 17072.

(c) (1) The provisions of this section shall be applied in lieu of the provisions of Sections 63(c) and 63(f) of the Internal Revenue Code, relating to standard deductions.

(2) Notwithstanding paragraph (1), Section 63(c)(5) of the Internal Revenue Code, relating to limitations on the standard deduction of certain dependents, and Section 63(c)(6)of the Internal Revenue Code, relating to certain individuals not eligible for the standard deduction, shall apply, except as otherwise provided. For purposes of this paragraph, the amount specified in Section 63(c)(5) of the Internal Revenue Code shall be adjusted for inflation in accordance with the provisions of Section 63(c)(4) of the Internal Revenue Code.

(d) For each taxable year beginning on or after January 1, 1988, the Franchise Tax Board shall recompute the standard deduction

amounts prescribed in subdivision (a). That computation shall be made as follows:

(1) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(2) The Franchise Tax Board shall compute an inflation adjustment factor by adding 100 percent to that portion of the percentage change figure which is furnished pursuant to paragraph (1) and dividing the result by 100.

(3) The Franchise Tax Board shall multiply the standard deduction amounts in the preceding taxable year by the inflation adjustment factor determined in paragraph (2), and round off the resulting products to the nearest one dollar ($1).

(4) In computing the standard deduction amounts pursuant to this subdivision, the amount provided in paragraph (2) of subdivision (a) shall be twice the amount provided in paragraph (1) of subdivision (a).

SEC. 17. Section 17085.8 of the Revenue and Taxation Code is repealed.

SEC. 18. Section 17088.5 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

17088.5. (a) Section 851(b)(3) of the Internal Revenue Code shall not apply.

(b) This section shall apply in determining whether an entity qualifies as a regulated investment company for income years of that entity beginning after August 5, 1997.

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

SEC. 19. Section 17088.6 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

17088.6. (a) Section 856(c)(4) of the Internal Revenue Code shall not apply.

(b) (1) Section 856(c)(6)(G) of the Internal Revenue Code shall not apply and in lieu thereof paragraph (2) shall apply.

(2) Except to the extent provided by regulations of the Secretary of the Treasury under Section 856(c)(5)(G) of the Internal Revenue Code (as redesignated and amended by Public Law 105-34), both of the following shall be treated as income qualifying under Section 856(c)(2) of the Internal Revenue Code:

(A) Any payment to a real estate investment trust under an interest rate swap or cap agreement, option, futures contract, forward rate agreement, or any similar financial instrument, entered into by the trust in a transaction to reduce the interest rate risks with respect to any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets.

(B) Any gain from the sale or other disposition of any such investment.

(c) This section shall apply in determining whether an entity qualifies as a real estate investment trust for income years of that entity beginning after August 5, 1997.

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

SEC. 20. Section 17132.6 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

17132.6. 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) The amendments made by the act adding this subdivision shall apply to taxable years beginning on or after January 1, 1998.

SEC. 21. Section 17140.3 is added to the Revenue and Taxation Code, 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 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. 22. 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.

SEC. 23. Section 17210.6 of the Revenue and Taxation Code is repealed.

SEC. 24. Section 17273.1 is added to the Revenue and Taxation Code, to read:

17273.1. (a) Notwithstanding Section 17273, for each taxable year beginning on or after January 1, 1998, and before January 1, 1999, Section 162(*l*)(1) of the Internal Revenue Code, relating to applicable percentage, is modified by substituting ''40 percent'' for the percentages specified in that section.

(b) This section shall remain in effect only until January 1, 1999, and as of that date is repealed.

SEC. 25. Section 17276 of the Revenue and Taxation Code is amended to read:

17276. Except as provided in Sections 17276.1 and 17276.2, the deduction provided by Section 172 of the Internal Revenue Code, relating to a net operating loss deduction, shall be modified as follows:

(a) (1) Net operating losses attributable to taxable years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any taxable year beginning before January 1, 1987.

(b) (1) Except as provided in paragraphs (2) and (3), the provisions of Section 172(b)(2) of the Internal Revenue Code, relating to the amount of carryovers, shall be modified so that 50 percent of the entire amount of the net operating loss for any taxable year shall not be eligible for carryover to any subsequent taxable year.

(2) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates a new business during that taxable year, each of the following shall apply to each loss incurred during the first three taxable years of operating the new business:

(A) If the net operating loss is equal to or less than the net loss from the new business, 100 percent of the net operating loss shall be carried forward as provided in paragraph (2) of subdivision (d).

(B) If the net operating loss is greater than the net loss from the new business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the new business, 100 percent of that amount shall be carried forward as provided in paragraph (2) of subdivision (d).

(ii) With respect to the portion of the net operating loss which exceeds the net loss from the new business, 50 percent of that amount shall be a net operating loss carryover to each of the five taxable years following the taxable year of the loss.

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall

be absorbed before the amount described in clause (i) of subparagraph (B).

(3) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates an eligible small business during that taxable year, each of the following shall apply:

(A) If the net operating loss is equal to or less than the net loss from the eligible small business, 100 percent of the net operating loss shall be carried forward to the taxable years specified in paragraph (1) of subdivision (d).

(B) If the net operating loss is greater than the net loss from the eligible small business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the eligible small business, 100 percent of that amount shall be carried forward to each of the five taxable years following the taxable year of the loss.

(ii) With respect to the portion of the net operating loss that exceeds the net loss from the eligible small business, 50 percent of that amount shall be a net operating loss carryover to each of the five taxable years following the taxable year of the loss.

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(4) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates a business that qualifies as both a new business and an eligible small business under this section, that business shall be treated as a new business for the first three taxable years of the new business.

(5) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates more than one business, and more than one of those businesses qualifies as either a new business or an eligible small business under this section, paragraph (2) shall be applied first, except that if there is any remaining portion of the net operating loss after application of clause (i) of subparagraph (B) of that paragraph, paragraph (3) shall be applied to the remaining portion of the net operating loss as though that remaining portion of the net operating loss constituted the entire net operating loss.

(6) For purposes of this section, the term ‘‘net loss’’ means the amount of net loss after application of Sections 465 and 469 of the Internal Revenue Code.

(c) Net operating loss carrybacks shall not be allowed.

(d) (1) Except as provided in paragraphs (2) and (3), for each taxable year beginning on or after January 1, 1987, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to

which net operating losses may be carried, is modified to substitute ''five taxable years'' in lieu of''20 taxable years.''

(2) In the case of a ''new business,'' the ''five taxable years'' in paragraph (1) shall be modified to read as follows:

(A) ''Eight taxable years'' for a net operating loss attributable to the first taxable year of that new business.

(B) ''Seven taxable years'' for a net operating loss attributable to the second taxable year of that new business.

(C) ''Six taxable years'' for a net operating loss attributable to the third taxable year of that new business.

(3) For any carryover of a net operating loss for which a deduction is denied by Section 17276.3, the carryover period specified in this subdivision shall be extended as follows:

(A) By one year for a net operating loss attributable to taxable years beginning in 1991.

(B) By two years for a net operating loss attributable to taxable years beginning prior to January 1, 1991.

(4) The net operating loss attributable to taxable years beginning on or after January 1, 1987, and before January 1, 1994, shall be a net operating loss carryover to each of the 10 taxable years following the year of the loss if it is incurred by a taxpayer that is under the jurisdiction of the court in a Title 11 or similar case at any time during the income year. The loss carryover provided in the preceding sentence shall not apply to any loss incurred after the date the taxpayer is no longer under the jurisdiction of the court in a Title 11 or similar case.

(e) For purposes of this section:

(1) ''Eligible small business'' means any trade or business that has gross receipts, less returns and allowances, of less than one million dollars ($1,000,000) during the taxable year.

(2) Except as provided in subdivision (f), ''new business'' means any trade or business activity that is first commenced in this state on or after January 1, 1994.

(3) ''Title 11 or similar case'' shall have the same meaning as in Section 368(a)(3) of the Internal Revenue Code.

(4) In the case of any trade or business activity conducted by a partnership or S corporation, paragraphs (1) and (2) shall be applied to the partnership or S corporation.

(f) For purposes of this section, in determining whether a trade or business activity qualifies as a new business under paragraph (2) of subdivision (e), the following rules shall apply:

(1) In any case where a taxpayer purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by the taxpayer (or any related person) shall not be treated as a new business if the aggregate fair market value

of the acquired assets (including real, personal, tangible, and intangible property) used by the taxpayer (or any related person) in the conduct of its trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the taxpayer (or any related person). For purposes of this paragraph only, the following rules shall apply:

(A) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the first taxable year in which the taxpayer (or any related person) first uses any of the acquired trade or business assets in its business activity.

(B) Any acquired assets that constituted property described in Section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(1) of the Internal Revenue Code in the hands of the acquiring taxpayer (or related person).

(2) In any case where a taxpayer (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (''prior trade or business activity''), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the taxpayer's (or any related person's) current or prior trade or business activities.

(3) In any case where a taxpayer, including all related persons, is engaged in trade or business activities wholly outside of this state and the taxpayer first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in paragraph (1)), the trade or business activity shall be treated as a new business under paragraph (2) of subdivision (e).

(4) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the taxpayer or partnership as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of paragraph (1) of this subdivision.

(5) ''Related person'' shall mean any person that is related to either the taxpayer under either Section 267 or 318 of the Internal Revenue Code.

(6) ''Acquire'' shall include any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

(7) (A) For taxable years beginning on or after January 1, 1997, the term ''new business'' shall include any taxpayer that is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and as further amended, and that has not received regulatory approval for any product from the United States Food and Drug Administration.

(B) For purposes of this paragraph:

(i) ''Biopharmaceutical activities'' means those activities which use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

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

(g) In computing the modifications under Section 172(d)(2) of the Internal Revenue Code, relating to capital gains and losses of taxpayers other than corporations, the exclusion provided by Section 18152.5 shall not be allowed.

(h) Notwithstanding any provisions of this section, a deduction shall be allowed to a ''qualified taxpayer'' as provided in Sections 17276.1 and 17276.2.

(i) The Franchise Tax Board may prescribe appropriate regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, tiered ownership structures, or otherwise.

(j) The Franchise Tax Board may reclassify any net operating loss carryover determined under either paragraph (2) or (3) of subdivision (b) as a net operating loss carryover under paragraph (1) of subdivision (b) upon a showing that the reclassification is necessary to prevent evasion of the purposes of this section.

(k) The amendments made by the act adding this subdivision shall be operative for taxable years beginning on or after January 1, 1997.

SEC. 26. Section 17279.4 is added to the Revenue and Taxation Code, to read:

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

(a) (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 for periods before the enactment of this section shall be made.

SEC. 27. Section 17279.5 of the Revenue and Taxation Code is amended to read:

17279.5. Section 264 of the Internal Revenue Code, relating to certain amounts paid in connection with insurance contracts, is modified to read as follows:

(a) No deduction shall be allowed for—

(1) Premiums on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the policy or contract.

(2) Any amount paid or accrued on indebtedness incurred to purchase or carry a single premium life insurance, endowment, or annuity contract. This paragraph shall apply with respect to annuity contracts only as to contracts purchased after December 31, 1954.

(3) Except as provided in subdivision (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of that contract (either from the insurer or otherwise). This paragraph shall apply only with respect to contracts purchased after August 6, 1963.

(4) Except as provided in subdivision (d), any interest paid or accrued on any indebtedness with respect to one or more insurance policies owned by the taxpayer covering the life of any individual, or any endowment or annuity contracts owned by the taxpayer covering the life of any individual, or any endowment or annuity contracts owned by the taxpayer covering any individual.

This paragraph shall apply with respect to contracts purchased after June 20, 1986.

(b) Paragraph (1) of subdivision (a) shall not apply to either of the following:

(1) Any annuity contract described in Section 72(s)(5) of the Internal Revenue Code.

(2) Any annuity contract to which Section 72(u) of the Internal Revenue Code applies.

(c) For purposes of paragraph (2) of subdivision (a), a contract shall be treated as a single premium contract if either of the following conditions exist:

(1) Substantially all the premiums on the contract are paid within a period of four years from the date on which the contract is purchased.

(2) An amount is deposited after December 31, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

(d) Paragraph (3) of subdivision (a) shall not apply to any amount paid or accrued by a person during a taxable year on indebtedness incurred or continued as part of a plan referred to in paragraph (3) of subdivision (a) if any of the following are applicable:

(1) No part of four of the annual premiums due during the seven-year period (beginning with the date the first premium on the contract to which that plan relates was paid) is paid under that plan by means of indebtedness.

(2) The total of the amounts paid or accrued by the person during that income year for which (without regard to this paragraph) no deduction would be allowable by reason of paragraph (3) of subdivision (a) does not exceed one hundred dollars ($100).

(3) That amount was paid or accrued on indebtedness incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in its financial obligations.

(4) That indebtedness was incurred in connection with its trade or business.

For purposes of applying paragraph (1), if there is a substantial increase in the premiums on a contract, a new seven-year period described in that paragraph with respect to that contract shall commence on the date the first that increased premium is paid.

(e) (1) Paragraph (4) of subdivision (a) shall not apply to any interest paid or accrued on any indebtedness with respect to policies or contracts covering an individual who is a key person to the extent that the aggregate amount of that indebtedness with respect to policies and contracts covering that individual does not exceed fifty thousand dollars ($50,000).

(2) (A) No deduction shall be allowed by reason of paragraph (1) or the last sentence of subdivision (a) with respect to interest paid or accrued for any month beginning after December 31, 1995, to the

extent the amount of that interest exceeds the amount which would have been determined if the applicable rate of interest were used for that month.

(B) For purposes of subparagraph (A):

(i) The applicable rate of interest for any month is the rate of interest described as Moody's Corporate Bond Yield Average-Monthly Average Corporates, as published by Moody's Investors Service, Inc., or any successor thereto, for that month.

(ii) In the case of indebtedness on a contract purchased on or before June 20, 1986, all of the following shall apply:

(I) If the contract provides a fixed rate of interest, the applicable rate of interest for any month shall be the Moody's rate described in clause (i) for the month in which the contract was purchased.

(II) If the contract provides a variable rate of interest, the applicable rate of interest for any month in an applicable period shall be the Moody's rate described in clause (i) for the third month preceding the first month in that period.

(III) For purposes of subclause (II), the term ''applicable period'' means the 12-month period beginning on the date the policy is issued (and each successive 12-month period thereafter) unless the taxpayer elects a number of months (not greater than 12) other than that 12-month period to be its applicable period. That election shall be made not later than the 90th day after the date of the enactment of the act adding this sentence and, if made, shall apply to the taxpayer's first taxable year ending on or after December 31, 1995, and all subsequent taxable years unless revoked with the consent of the Franchise Tax Board.

(3) For purposes of paragraph (1), ''key person'' means an officer or 20-percent owner, except that the number of individuals who may be treated as key persons with respect to any taxpayer shall not exceed the greater of:

(A) Five individuals.

(B) The lesser of 5 percent of the total officers and employees of the taxpayer or 20 individuals.

(4) For purposes of this subdivision, ''20-percent owner'' means both of the following:

(A) If the taxpayer is a corporation, any person who owns directly 20 percent or more of the outstanding stock of the corporation or stock possessing 20 percent or more of the total combined voting power of all stock of the corporation.

(B) If the taxpayer is not a corporation, any person who owns 20 percent or more of the capital or profits interest in the taxpayer.

(5) (A) For purposes of subparagraph (A) of paragraph (4) and for purposes of applying the fifty thousand dollar ($50,000) limitation in paragraph (1) both of the following shall apply:

(i) All members of a controlled group shall be treated as one taxpayer.

(ii) The limitation shall be allocated among the members of the controlled group in the manner the Franchise Tax Board may prescribe.

(B) For purposes of this paragraph, all persons treated as a single employer under Section 52(a) or 52(b) of the Internal Revenue Code, relating to special rules, or Section 414(m) or 414(o) of the Internal Revenue Code, relating to definitions and special rules, shall be treated as members of a controlled group.

(f) (1) No deduction shall be allowed for that portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values.

(2) For purposes of paragraph (1), the portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values is an amount which bears the same ratio to the interest expense as:

(A) The taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, bears to

(B) The sum of:

(i) In the case of assets of the taxpayer which are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values of those policies and contracts, and

(ii) In the case of assets of the taxpayer not described in clause (i), the average adjusted bases (within the meaning of Section 1016 of the Internal Revenue Code) of those assets.

(3) For purposes of this subdivision, the term ''unborrowed policy cash value'' means, with respect to any life insurance policy or annuity or endowment contract, the excess of:

(A) The cash surrender value of the policy or contract determined without regard to any surrender charge, over

(B) The amount of any loan with respect to that policy or contract.

(4) (A) Paragraph (1) shall not apply to any policy or contract owned by an entity engaged in a trade or business if the policy or contract covers only one individual and if that individual is (at the time first covered by the policy or contract):

(i) A 20-percent owner of the entity, or

(ii) An individual (not described in clause (i)) who is an officer, director, or employee of that trade or business.

A policy or contract covering a 20-percent owner of the entity shall not be treated as failing to meet the requirements of the preceding sentence by reason of covering the joint lives of the owner and the owner's spouse.

(B) Paragraph (1) shall not apply to any annuity contract to which Section 72(u) of the Internal Revenue Code applies.

(C) Any policy or contract to which paragraph (1) does not apply by reason of this paragraph shall not be taken into account under paragraph (2).

(D) For purposes of subparagraph (A), the term ‘‘20-percent owner’’ has the meaning given that term by paragraph (4) of subdivision (e).

(5) (A) (i) This subdivision shall not apply to any policy or contract held by a natural person.

(ii) If a trade or business is directly or indirectly the beneficiary under any policy or contract, the policy or contract shall be treated as held by that trade or business and not by a natural person.

(iii) (I) Clause (ii) shall not apply to any trade or business carried on as a sole proprietorship and to any trade or business performing services as an employee.

(II) The amount of the unborrowed cash value of any policy or contract which is taken into account by reason of clause (ii) shall not exceed the benefit to which the trade or business is directly or indirectly entitled under the policy or contract.

(iv) A copy of the report required for federal purposes under Section 264(f) of the Internal Revenue Code shall be filed with the Franchise Tax Board at the time and in the manner specified for federal purposes and shall be treated as a statement referred to in Section 6724(d)(1) of the Internal Revenue Code.

(B) In the case of a partnership or S corporation, this subdivision shall be applied at the partnership and corporate levels.

(6) (A) If interest on any indebtedness is disallowed under subdivision (a) or Section 17280, both of the following shall apply:

(i) The disallowed interest shall not be taken into account for purposes of applying this subdivision.

(ii) The amount otherwise taken into account under subparagraph (B) of paragraph (2) shall be reduced (but not below zero) by the amount of the indebtedness.

(B) This subdivision shall be applied before the application of Section 263A of the Internal Revenue Code, relating to capitalization of certain expenses where taxpayer produces property.

(7) The term ‘‘interest expense’’ means the aggregate amount allowable to the taxpayer as a deduction for interest (within the meaning of Section 265(b)(4) of the Internal Revenue Code) for the taxable year (determined without regard to this subdivision, Section 265(b) of the Internal Revenue Code, and Section 291 of the Internal Revenue Code).

(8) All members of a controlled group (within the meaning of subparagraph (B) of paragraph (5) of subdivision (e)) shall be treated as one taxpayer for purposes of this subdivision.

(g) (1) The amendments made to this section by the act adding this subdivision shall apply to interest paid or accrued after December 31, 1995.

(2) (A) The amendments made to this section by the act adding this subdivision shall not apply to qualified interest paid or accrued

on that indebtedness after December 31, 1995, and before January 1, 1999, in the case of either of the following:

(i) Indebtedness incurred before January 1, 1996.

(ii) Indebtedness incurred before January 1, 1997, with respect to any contract or policy entered into in 1994 or 1995.

(B) For purposes of subparagraph (A), the qualified interest with respect to any indebtedness for any month is the amount of interest (otherwise deductible) which would be paid or accrued for that month on that indebtedness if—

(i) In the case of any interest paid or accrued after December 31, 1995, indebtedness with respect to no more than 20,000 insured individuals were taken into account, and

(ii) The lesser of the following rates of interest were used for that month:

(I) The rate of interest specified under the terms of the indebtedness as in effect on December 31, 1995 (and without regard to modification of the terms after that date).

(II) The applicable percentage of the rate of interest described as Moody's Corporate Bond Yield Average-Monthly Average Corporates, as published by Moody's Investors Service, Inc., or any successor thereto, for that month. For purposes of clause (i), all persons treated as a single employer under Section 52(a) or 52(b) of the Internal Revenue Code, relating to special rules, or Section 414(m) or 414(o) of the Internal Revenue Code, relating to definitions and special rules, shall be treated as one person. Subclause (II) of clause (ii) shall not apply to any month before January 1, 1996.

(C) For purposes of subparagraph (B), the applicable percentage is as follows:

For calendar year:	The percentage is:
1996	100 percent
1997	90 percent
1998	80 percent

(3) This subdivision shall not apply to any contract purchased on or before June 20, 1986, except that paragraph (2) of subdivision (d) shall apply to interest paid or accrued after December 31, 1995.

(h) (1) Any amount received under any life insurance policy or endowment or annuity contract described in paragraph (4) of subdivision (a) shall be includable in gross income (in lieu of any other inclusion in gross income) ratably over the four taxable year period beginning with the taxable year that amount would (but for this paragraph) be includable, upon the occurrence of either of the following:

(A) The complete surrender, redemption, or maturity of that policy or contract during the calendar year 1996, 1997, or 1998.

(B) The full discharge during calendar year 1996, 1997, or 1998, of the obligation under the policy or contract which is in the nature of a refund of the consideration paid for the policy or contract.

(2) Paragraph (1) shall only apply to the extent the amount is includable in gross income for the taxable year in which the event described in subparagraph (A) or (B) of paragraph (1) occurs.

(3) Solely by reason of an occurrence described in subparagraph (A) or (B) of paragraph (1) or solely by reason of no additional premiums being received under the contract by reason of a lapse occurring after December 31, 1995, a contract shall not be treated as either of the following:

(A) Failing to meet the requirement of paragraph (1) of subdivision (c).

(B) A single premium contract under paragraph (1) of subdivision (b).

(i) The amendments made by the act adding this subdivision shall apply to contracts issued after June 8, 1997, in taxable years beginning on or after January 1, 1998. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract, except that the addition of covered lives shall be treated as a new contract only with respect to those additional covered lives. For purposes of this subdivision, an increase in the death benefit under a policy or contract issued in connection with a lapse described in Section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

SEC. 28. Section 17507.4 of the Revenue and Taxation Code is repealed.

SEC. 29. Section 17507.6 of the Revenue and Taxation Code is amended to read:

17507.6. Section 408A of the Internal Revenue Code, relating to Roth IRAs, is modified to additionally provide all of the following:

(a) Section 408A(d)(3) of the Internal Revenue Code, relating to rollovers from an IRA other than a Roth IRA, shall not apply if any distribution which is not a qualified distribution under Section 408A(d)(2) of the Internal Revenue Code is made from a Roth IRA within the five-taxable-year period beginning with the taxable year in which a distribution to which Section 408A(d)(3) of the Internal Revenue Code would otherwise apply is made.

(b) In the case of any distribution to which subdivision (a) applies:

(1) There shall be included in gross income in the taxable year in which the disqualifying distribution described in subdivision (a) is made any amount that has not been previously included in gross income under Section 408A(d)(3)(A)(iii) of the Internal Revenue Code and which would be includable in income were it not treated as part of a qualified rollover contribution.

(2) In the taxable year in which the disqualifying distribution described in subdivision (a) is made, Section 72(t) of the Internal Revenue Code shall be applied to the amount which was treated as includable in gross income under Section 408A(d)(3)(A)(i) of the Internal Revenue Code.

SEC. 30. Section 17559 of the Revenue and Taxation Code, as added by Section 8 of Chapter 7 of the Statutes of 1998, is amended to read:

17559. (a) Section 451(e) of the Internal Revenue Code, relating to special rule for proceeds from livestock sold on account of drought, is modified by substituting the phrase ''drought, flood, or other weather-related conditions, and that those conditions'' in lieu of the phrase ''drought conditions, and that these drought conditions'' contained therein.

(b) This section shall apply to sales and exchanges after December 31, 1996.

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

SEC. 31. Section 17564 of the Revenue and Taxation Code is amended to read:

17564. (a) Long-term contracts shall be accounted for in accordance with the special rules set forth in Section 460 of the Internal Revenue Code.

(b) (1) The provisions of Section 804(d) of Public Law 99-514, relating to the effective date of modifications in the method of accounting for long-term contracts, shall be applicable to taxable years beginning on or after January 1, 1987.

(2) In the case of a contract entered into after February 28, 1986, during a taxable year beginning before January 1, 1987, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between state and federal law for the taxable year in which the contract began.

(c) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 10203 of Public Law 100-203, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to taxable years beginning on or after January 1, 1990.

(2) In the case of a contract entered into after October 13, 1987, during a taxable year beginning before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between California and federal law for taxable years beginning prior to January 1, 1990.

(d) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 5041 of Public Law 100-647, relating to a

reduction in the percentage of items taken into account under the completed contract method, shall apply to taxable years beginning on or after January 1, 1990.

(2) In the case of a contract entered into after June 20, 1988, during a taxable year beginning before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between California and federal law for taxable years beginning prior to January 1, 1990.

(e) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 7621 of Public Law 101-239, relating to the repeal of the completed contract method of accounting for long-term contracts, shall apply to taxable years beginning on or after January 1, 1990.

(2) In the case of a contract entered into after July 10, 1989, during a taxable year beginning before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between California and federal law for taxable years beginning prior to January 1, 1990.

(f) For purposes of applying paragraphs (2) to (6), inclusive, of Section 460(b) of the Internal Revenue Code, relating to the look-back method, any adjustment to income computed under paragraph (2) of subdivision (b), (c), (d), or (e) shall be deemed to have been reported in the taxable year from which the adjustment arose, rather than the taxable year in which the contract was completed.

SEC. 32. Section 17570 of the Revenue and Taxation Code is amended to read:

17570. (a) For each taxable year beginning on or after January 1, 1997, Section 475 of the Internal Revenue Code, relating to mark to market accounting method for securities dealers, shall apply, except as otherwise provided.

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

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

allowed under paragraph (3) of subdivision (e) of Section 17024.5, and the federal election shall be binding for purposes of this part.

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

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

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

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

(2) If a taxpayer fails to make, or has not previously made, an election for federal purposes under Section 475(f)(2) of the Internal Revenue Code, relating to election of mark to market for traders in commodities, to have Section 475 of the Internal Revenue Code apply

to a trade or business, an election under Section 475(f)(2) of the Internal Revenue Code shall not be allowed for state purposes with respect to that trade or business, Section 475 of the Internal Revenue Code shall not apply to that trader in commodities for state purposes with respect to that trade or business, and a separate election for state purposes with respect to that trade or business shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5.

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

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

SEC. 33. Section 17751 is added to the Revenue and Taxation Code, to read:

17751. Section 646 of the Internal Revenue Code, relating to certain revocable trusts treated as part of estate, is modified as follows:

(a) An election under Section 646(a) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as an election made by the executor, if any, of the estate and the trustee of the qualified revocable trust under Section 646(a) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(b) If the executor, if any, of the estate and the trustee of a qualified revocable trust fail to make an election under Section 646(a) of the Internal Revenue Code for federal purposes with respect to that qualified revocable trust, that trust shall be treated and taxed for purposes of this part as a separate trust, an election under Section 646(a) of the Internal Revenue Code for state purposes with respect to that trust shall not be allowed, and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed with respect to that trust.

SEC. 34. Section 17752 is added to the Revenue and Taxation Code, to read:

17752. Section 663 of the Internal Revenue Code, relating to special rules applicable to Sections 661 and 662, is modified as follows:

(a) Section 663(b) of the Internal Revenue Code, relating to distributions in the first 65 days of the taxable year, is modified as follows:

(1) An election under Section 663(b) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as an election made by the executor of the estate or the fiduciary of the trust, as the case may be, under Section 663(b) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(2) If the executor of the estate or the fiduciary of the trust, as the case may be, fails to make an election under Section 663(b) of the Internal Revenue Code for federal purposes with respect to an amount properly paid or credited within 65 days of the taxable year, that amount shall not be considered for purposes of this part as having been paid or credited on the last day of the preceding taxable year, an election under Section 663(b) of the Internal Revenue Code for state purposes with respect to that amount shall not be allowed, and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed with respect to that amount.

(b) Section 663(c) of the Internal Revenue Code, relating to separate shares treated as separate estates or trusts, is modified as follows:

(1) An election under Section 663(c) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as an election made by the executor of the estate or the fiduciary of the trust, as the case may be, under Section 663(c) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(2) If the executor of the estate or the fiduciary of the trust, as the case may be, fails to make an election under Section 663(c) of the Internal Revenue Code for federal purposes with respect to separate shares treated as separate estates or trusts, an election under Section 663(c) of the Internal Revenue Code for state purposes shall not be allowed, and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

SEC. 35. Section 17760.5 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

17760.5. Section 685 of the Internal Revenue Code, relating to treatment of funeral trusts, is modified as follows:

(a) Section 685(a) of the Internal Revenue Code is modified to read: In the case of a qualified funeral trust—

(1) Subparts B, C, D, and E of Subchapter J of Chapter 1 of Subtitle A of the Internal Revenue Code shall not apply.

(2) No credit for personal exemption shall be allowed under Section 17054 or Section 17733.

(b) Section 685(b) of the Internal Revenue Code is modified as follows:

(1) An election under Section 685(b)(5) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as an election made by the trustee of the qualified funeral trust under Section 685(b)(5) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed.

(2) If the trustee of a qualified funeral trust fails to make an election under Section 685(b)(5) of the Internal Revenue Code for federal purposes with respect to a qualified funeral trust, that trust shall be treated for purposes of this part as owned under Subpart E of the Internal Revenue Code by the purchasers of the contracts described in Section 685(b)(1) of the Internal Revenue Code, an election under Section 685(b)(5) of the Internal Revenue Code for state purposes with respect to that trust shall not be allowed, and a separate election under paragraph (3) of subdivision (e) of Section 17024.5 shall not be allowed with respect to that trust.

(c) Section 685(d) of the Internal Revenue Code is modified to read: Subdivision (e) of Section 17041 shall be applied to each qualified funeral trust by treating each beneficiary's interest in each qualified funeral trust as a separate trust.

(d) The Franchise Tax Board may, by forms and instructions, provide rules for simplified reporting of all trusts having a single trustee consistent with the rules prescribed by the Secretary of the Treasury under Section 685 of the Internal Revenue Code.

(e) This section shall apply to taxable years ending after August 5, 1997.

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

SEC. 36. Section 17856 of the Revenue and Taxation Code is amended to read:

17856. The provisions of Section 751(d)(3) of the Internal Revenue Code, relating to appreciated inventory items subject to tax as a gain on foreign investment company stock, shall not be applicable.

SEC. 37. Section 17865 is added to the Revenue and Taxation Code, to read:

17865. Part IV of Subchapter K of Chapter 1 of Subtitle A of the Internal Revenue Code (commencing with Section 771 of the Internal Revenue Code), shall not apply, except as otherwise provided.

SEC. 38. Section 18037.3 of the Revenue and Taxation Code, as added by Section 12 of Chapter 7 of the Statutes of 1998, is amended to read:

18037.3. (a) Section 1033(e) of the Internal Revenue Code, relating to livestock sold on account of drought, is modified by substituting the phrase ''on account of drought, flood, or other weather-related conditions'' in lieu of the phrase ''on account of drought'' contained therein.

(b) This section shall apply to sales and exchanges after December 31, 1996.

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

SEC. 39. Section 18037.6 of the Revenue and Taxation Code is repealed.

SEC. 40. Section 18038.4 is added to the Revenue and Taxation Code, to read:

18038.4. Section 1045 of the Internal Revenue Code, relating to rollover of gain from qualified small business stock to another qualified small business stock, shall not apply.

SEC. 41. Section 18042 of the Revenue and Taxation Code is amended to read:

18042. (a) Section 1042 of the Internal Revenue Code, relating to sales of stock to employee stock ownership plans or certain cooperatives, shall apply to taxable years beginning on or after January 1, 1995.

(b) For taxable years beginning on or after January 1, 1998, Section 1042 of the Internal Revenue Code, relating to sales of stock to employee stock ownership plans or certain cooperatives, is modified to provide that the term ''domestic corporation'' shall instead mean ''domestic C corporation.''

(c) Section 1042(g) of the Internal Revenue Code, relating to application of section to sales of stock in agricultural refiners and processors to eligible farm cooperatives, shall not apply.

SEC. 42. Section 18178 of the Revenue and Taxation Code is amended to read:

18178. Section 1272 of the Internal Revenue Code shall be modified as follows:

(a) For taxable years beginning on or after January 1, 1987, and before the taxable year in which the debt obligation matures or is sold, exchanged, or otherwise disposed, the amount included in gross income under this part shall be the same as the amount included in gross income on the federal tax return.

(b) The difference between the amount included in gross income on the federal return and the amount included in gross income under this part, with respect to obligations issued after December 31, 1984, for taxable years beginning before January 1, 1987, shall be included in gross income in the taxable year in which the debt obligation matures or is sold, exchanged, or otherwise disposed.

(c) Section 1004(b) of the Taxpayer Relief Act of 1997 (P.L. 105-34), relating to the effective date for determination of original

issue discount where pooled debt obligations are subject to acceleration, is modified to provide that the changes to Section 1272(a)(6) of the Internal Revenue Code made by the act adding this subdivision shall apply to taxable years beginning on or after January 1, 1998, and the amount taken into account under Section 481 of the Internal Revenue Code shall be taken into account ratably over the four-taxable-year period beginning with the first taxable year beginning on or after January 1, 1998.

SEC. 43. Section 18505 of the Revenue and Taxation Code is amended to read:

18505. (a) Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) taxable under Part 10 (commencing with Section 17001) shall make a return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, for any of the following taxpayers for whom he or she acts, stating specifically the items of gross income of the taxpayer and the deductions and credits allowed:

(1) Every individual having an adjusted gross income for the taxable year in excess of six thousand dollars ($6,000), if single.

(2) Every individual having an adjusted gross income for the taxable year in excess of twelve thousand dollars ($12,000), if married.

(3) Every individual having a gross income for the taxable year in excess of eight thousand dollars ($8,000), regardless of the amount of adjusted gross income.

(4) Every estate the net income of which for the taxable year is in excess of one thousand dollars ($1,000).

(5) Every trust (not treated as a corporation under Section 23038) the net income of which for the taxable year is in excess of one hundred dollars ($100).

(6) Every estate or trust (not treated as a corporation under Section 23038) the gross income of which for the taxable year is in excess of eight thousand dollars ($8,000), regardless of the amount of the net income.

(7) Every decedent, for the year in which death occurred, and for prior years, if returns for those years should have been filed but have not been filed by the decedent, under the rules and regulations that the Franchise Tax Board may prescribe.

(b) The fiduciary of any estate or trust required to file a return under subdivision (a), for any taxable year shall, on or before the date on which that return was required to be filed, furnish to each beneficiary (or nominee thereof) a statement in accordance with the provisions of Section 6034A of the Internal Revenue Code.

(c) For taxable or income years beginning on or after January 1, 1998:

(1) A beneficiary of any estate or trust to which subdivision (b) applies shall, on that beneficiary’s return, treat any reported item in

a manner which is consistent with the treatment of that item on the applicable entity's return.

(2) (A) In the case of any reported item, paragraph (1) shall not apply to that item if:

(i) (I) The applicable entity has filed a return but the beneficiary's treatment on that beneficiary's return is (or may be) inconsistent with the treatment of the item on the applicable entity's return, or

(II) The applicable entity has not filed a return, and

(ii) The beneficiary files with the Franchise Tax Board a statement identifying the inconsistency.

(B) A beneficiary shall be treated as having complied with clause (ii) of subparagraph (A) with respect to a reported item if the beneficiary does both of the following:

(i) Demonstrates to the satisfaction of the Franchise Tax Board that the treatment of the reported item on the beneficiary's return is consistent with the treatment of the item on the statement furnished under subdivision (b) to the beneficiary (or nominee thereof) by the applicable entity.

(ii) Elects to have this paragraph apply with respect to that item.

(3) In any case described in subclause (I) of clause (i) of subparagraph (A) of paragraph (2), in which the beneficiary does not comply with clause (ii) of subparagraph (A) of paragraph (2), any adjustment required to make the treatment of the items by the beneficiary consistent with the treatment of the items on the applicable entity's return shall be treated as arising out of mathematical or clerical errors and assessed and collected under Section 19051.

(4) For purposes of this subdivision:

(A) The term ''reported item'' means any item for which information is required to be furnished under subdivision (b).

(B) The term ''applicable entity'' means the estate or trust of which the taxpayer is the beneficiary.

(5) The penalties imposed under Article 7 (commencing with Section 19131) of Chapter 4 shall apply in the case of a beneficiary's negligence in connection with, or disregard of, the requirements of this subdivision.

(d) The amendments made by the act adding this subdivision shall apply to returns of beneficiaries and owners filed on or after January 1, 1998.

SEC. 44. Section 18510 of the Revenue and Taxation Code, as amended by Chapter 7 of the Statutes of 1998, is amended to read:

18510. For taxable years beginning on or after January 1, 1997, for purposes of Sections 18501, 18505, and 18521, gross income shall be computed without regard to the exclusion provided for in Section 121 of the Internal Revenue Code, relating to exclusion of gains from sale of principal residence.

SEC. 45. Section 18572 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

18572. (a) In the case of an individual taxpayer determined by the Secretary of the Treasury or the Franchise Tax Board to be affected by a presidentially declared disaster (as defined by Section 1033(h)(3) of the Internal Revenue Code), under regulations prescribed by the Secretary of the Treasury, unless the Franchise Tax Board prescribes differently, a period of up to 90 days may be disregarded in determining, in respect of any tax liability (including any penalty, additional amount, or addition to the tax) of the taxpayer:

(1) Whether any of the acts described in paragraph (1) of Section 7508(a)(1) of the Internal Revenue Code were performed within the time prescribed therefor.

(2) The amount of any credit or refund.

(b) Subdivision (a) shall not apply for the purposes of determining interest on any overpayment or underpayment.

(c) This section shall apply with respect to any period for performing an act that has not expired before August 5, 1997.

SEC. 46. Section 18641 of the Revenue and Taxation Code is amended to read:

18641. (a) Every person doing business as a broker shall, when required by the Franchise Tax Board, make a return, in accordance with regulations as the Franchise Tax Board may prescribe, showing the name and address of each customer, with details regarding gross proceeds and any other information which the Franchise Tax Board may by forms or regulations require with respect to that business.

(b) (1) Every person required to make a return under subdivision (a) shall furnish to each customer whose name is required to be set forth in that return a written statement showing all of the following:

(A) The name and address of the person required to make that return.

(B) The information required to be shown on that return with respect to that customer.

(2) The written statement required under paragraph (1) shall be furnished to the customer on or before January 31 of the year following the calendar year for which the return under subdivision (a) was required to be made.

(c) For purposes of this section:

(1) ''Broker'' includes any of the following:

(A) A dealer.

(B) A barter exchange.

(C) Any other person, who, for a consideration, regularly acts as a middleman with respect to personal property or services. A person shall not be treated as a broker with respect to activities consisting of managing a farm on behalf of another person.

(2) ''Customer'' means any person for whom the broker has transacted any business.

(3) ''Barter exchange'' means any organization of members providing personal property or services who jointly contract to trade or barter that personal property or services.

(4) ''Person'' includes any governmental unit and any agency or instrumentality thereof.

(d) (1) Any person engaged in a trade or business and making a payment (in the course of that trade or business) to which this subdivision applies shall file a return under subdivision (a) and a statement under subdivision (b) with respect to that payment.

(2) (A) This subdivision shall apply to any payment to an attorney in connection with legal services (whether or not those services are performed for the payer).

(B) This subdivision shall not apply to the portion of any payment which is required to be reported under subdivision (a) of Section 18637 (or would be so required but for the dollar limitation contained therein).

(e) (1) Any regulations which apply to payments subject to the reporting requirements imposed under Section 18637 that provide an exception for payments made to corporations shall not apply to payments of attorneys' fees.

(2) The regulations under Section 6041 of the Internal Revenue Code, relating to providing an exception for payments made to corporations, shall not be used to interpret the requirements under Section 18637 with respect to payments of attorneys' fees.

(f) If the taxpayer has complied with the requirements of Section 6045(f) of the Internal Revenue Code for federal purposes, the taxpayer shall be deemed to have complied with the requirements of subdivision (d) for purposes of this part and no penalty shall be imposed under Section 19183.

(g) The amendments made by the act adding this subdivision shall apply to payments made after December 31, 1997.

(h) In lieu of the return required by subdivision (a), a copy of the similar return filed with the Internal Revenue Service pursuant to Section 6045 of the Internal Revenue Code, and the regulations adopted thereto, may be filed with the Franchise Tax Board.

SEC. 47. Section 18645 of the Revenue and Taxation Code is amended to read:

18645. (a) The Franchise Tax Board may require a copy of the federal information return to be filed with the Franchise Tax Board if a federal information return was required under any of the following:

(1) Section 6039C of the Internal Revenue Code, relating to returns with respect to foreign persons holding direct investments in United States real property interests, if that person holds a direct

investment in a California real property interest as defined in Section 18662.

(2) Section 6050H of the Internal Revenue Code, relating to mortgage interest received in trade or business from individuals.

(3) Section 6050J of the Internal Revenue Code, relating to foreclosures and abandonments of security.

(4) Section 6050K of the Internal Revenue Code, relating to exchanges of certain partnership interests.

(5) Section 6050L of the Internal Revenue Code, relating to certain dispositions of donated property.

(6) Section 6050N of the Internal Revenue Code, relating to returns regarding payments of royalties.

(7) Section 6050P of the Internal Revenue Code, relating to returns relating to the cancellation of indebtedness by certain financial entities.

(8) Section 6050Q of the Internal Revenue Code, relating to certain long-term care benefits.

(9) Section 6050R of the Internal Revenue Code, relating to returns relating to certain purchases of fish.

(10) Section 6050S of the Internal Revenue Code, relating to returns relating to higher education tuition and related expenses.

(b) Every person required to make a return under subdivision (a) shall also furnish a statement to each person whose name is required to be set forth in the return, as required to do so by the Internal Revenue Code.

(c) A transferor of a partnership interest shall be required to notify the partnership of that exchange in accordance with Section 6050K(c) of the Internal Revenue Code.

(d) The Franchise Tax Board shall require a copy of the federal information return to be filed with the Franchise Tax Board if a federal information return was required under Section 6050I(a) of the Internal Revenue Code, relating to cash received in trade or business. Section 6050I(g) of the Internal Revenue Code, relating to cash received by criminal court clerks, shall not apply.

(e) (1) The Attorney General shall, upon court order following a showing ex parte to a magistrate of an articulable suspicion that an individual or entity has committed a felony offense to which a federal information return is related, be provided a copy of a federal information return filed with the Franchise Tax Board under subdivision (d). The Attorney General may make a return or information therefrom available to a district attorney subject to regulations promulgated by the Attorney General. The regulations shall require the district attorney seeking the return or information to specify in writing the specific reasons for believing that a felony offense has been committed to which the return or information is related.

(2) Any information or return obtained by the Attorney General or a district attorney pursuant to this section shall be confidential and used only for investigative or prosecutorial purposes.

SEC. 48. Section 19057 of the Revenue and Taxation Code is amended to read:

19057. (a) Except in the case of a false or fraudulent return and except as otherwise expressly provided in this part, every notice of a proposed deficiency assessment shall be mailed to the taxpayer within four years after the return was filed. No deficiency shall be assessed or collected with respect to the year for which the return was filed unless the notice is mailed within the four-year period or the period otherwise provided. For purposes of this chapter, the term ''return'' means the return required to be filed by the taxpayer and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit.

(b) The running of the period of limitations provided in subdivision (a) on mailing a notice of proposed deficiency assessment shall, in a case under Title 11 of the United States Code, be suspended for any period during which the Franchise Tax Board is prohibited by reason of that case from mailing the notice of proposed deficiency assessment and 60 days thereafter.

(c) Where, within the 60-day period ending on the day on which the time prescribed in this section for the assessment of any tax imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) for any taxable year would otherwise expire, the Franchise Tax Board receives a written document, other than an amended return or a report required by Section 18622, signed by the taxpayer showing that the taxpayer owes an additional amount of that tax for that taxable year, the period for the assessment of an additional amount in excess of the amount shown on either an original or amended return shall not expire before the day 60 days after the day on which the Franchise Tax Board receives that document.

(d) If a taxpayer determines in good faith that it is an exempt organization and files a return as such under Section 23772, and if the taxpayer is thereafter held to be a taxable organization for the taxable year for which the return is filed, that return shall be deemed the return of the organization for the purposes of this section.

SEC. 49. Section 19066.5 is added to the Revenue and Taxation Code, to read:

19066.5. In the case of any information that is required to be reported to the Franchise Tax Board under Section 19141.2 or 19141.5, the time for assessment of any tax imposed by Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part with respect to any event or period to which that information relates shall not expire before the date that is four years after the date on which the Franchise Tax Board is

furnished the information required to be reported under Section 19141.2 or 19141.5, or within the periods provided in Section 19057, 19058, 19059, 19060, 19065, 24945, 24946, Section 1033(a)(2)(C) of the Internal Revenue Code, or Section 1033(a)(2)(D) of the Internal Revenue Code, whichever period expires later.

SEC. 50. Section 19132 of the Revenue and Taxation Code is amended to read:

19132. (a) (1) Unless it is shown that the failure is due to reasonable cause and not due to willful neglect, a penalty computed in accordance with paragraph (2) is hereby imposed in the case of failure to pay any of the following:

(A) The amount shown as tax on any return on or before the date prescribed for payment of that tax determined with regard to any extension of time for payment.

(B) Any amount in respect of any tax required to be shown on a return which is not so shown including an assessment made pursuant to Section 19051 within 15 days of the date of the notice and demand therefor.

(C) The amount required to be paid by Section 19021, if applicable, that is not paid.

(D) The amount required to be paid by Section 17941 or 23091, if applicable, that is not paid.

(E) The amount required to be paid by Section 17948 or 23097, if applicable, that is not paid.

(2) The penalty imposed under paragraph (1) shall consist of both of the following:

(A) Five percent of the total tax unpaid as defined in subdivision (c).

(B) An amount computed at the rate of 0.5 percent per month of the ‘‘remaining tax’’ as defined in subdivision (d) for each additional month or fraction thereof not to exceed 40 months during which the ‘‘remaining tax’’ is greater than zero.

(3) The aggregate amount of penalty imposed by this subdivision shall not exceed 25 percent of the total unpaid tax and shall be due and payable upon notice and demand by the Franchise Tax Board. The tender of a check or money order does not constitute payment of the tax for purposes of this section unless the check or money order is paid on presentment.

(b) The penalty prescribed by subdivision (a) shall not be assessed if, for the same taxable year, the sum of any penalties imposed under Section 19131 relating to failure to file return and Section 19133 relating to failure to file return after demand is equal to or greater than the subdivision (a) penalty. In the event the penalty imposed under subdivision (a) is greater than the sum of any penalties imposed under Sections 19131 and 19133, the penalty imposed under subdivision (a) shall be the amount which exceeds the sum of any penalties imposed under Sections 19131 and 19133.

(c) For purposes of this section, total tax unpaid means the amount of tax shown on the return reduced by both of the following:

(1) The amount of any part of the tax which is paid on or before the date prescribed for payment of the tax.

(2) The amount of any credit against the tax which may be claimed upon the return.

(d) For purposes of this section, ''remaining tax'' means total tax unpaid reduced by the amount of any payment of the tax.

(e) If the amount required to be shown as a tax on a return is less than the amount shown as tax on that return, subdivisions (a), (c), and (d) shall be applied by substituting that lower amount.

(f) No interest shall accrue on the portion of the penalty prescribed in subparagraph (B) of paragraph (2) of subdivision (a).

(g) The amendments made by the act adding this subdivision are operative for notices issued on or after January 1, 1998.

SEC. 51. Section 19133.5 of the Revenue and Taxation Code is amended to read:

19133.5. (a) In the case of a failure to make a report required under Section 18152.5 that contains the information required by that section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Franchise Tax Board and in the same manner as tax) by the person failing to make the report, an amount equal to fifty dollars ($50) for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard, the preceding sentence shall be applied by substituting one hundred dollars ($100) for fifty dollars ($50). In the case of a report covering periods in two or more years, the penalty determined under preceding provisions of this section shall be multiplied by the number of those years.

(b) This section shall become operative on January 1, 1994.

(c) No penalty shall be imposed under this section for any failure that is shown to be due to reasonable cause and not willful neglect.

(d) The amendments made by the act adding this subdivision shall become operative on January 1, 1998.

SEC. 52. Section 19136 of the Revenue and Taxation Code is amended to read:

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

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

(c) (1) For purposes of Section 6654(d) of the Internal Revenue Code, relating to the amount of required installments, any reference to ''90 percent'' is modified to read ''80 percent.''

(2) Section 6654(d)(2)(C)(ii) of the Internal Revenue Code, relating to applicable percentages, is modified as follows:

In the case of the following required installments:	The applicable percentage is:
1st	20
2nd	40
3rd	60
4th	80

(3) The annualized income installment, determined under Section 6654(d)(2) of the Internal Revenue Code, shall not include ''alternative minimum taxable income'' or ''adjusted self-employment income.''

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

(2) No addition to the tax shall be imposed under this section if any of the following apply:

(A) The tax imposed under Section 17041 or 17048 for the preceding taxable year, minus the sum of any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, or the tax computed under Section 17041 or 17048 upon the estimated income for the taxable year, minus the sum of any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, is less than two hundred dollars ($200), except in the case of a separate return filed by a married person the amount shall be less than one hundred dollars ($100).

(B) Eighty percent or more of the tax imposed under Section 17041 or 17048 for the preceding taxable year, less any credits against the tax other than the credit allowed under Section 19002, was paid by withholding pursuant to Section 18662 or 18666 of this code or Section 13020 of the Unemployment Insurance Code.

(C) Eighty percent or more of the estimated tax for the taxable year will be paid by withholding of tax pursuant to Section 18662 or 18666 of this code or Section 13020 of the Unemployment Insurance Code.

(D) Eighty percent or more of the adjusted gross income for the taxable year consists of items subject to withholding pursuant to Section 18662 or 18666 of this code or Section 13020 of the Unemployment Insurance Code.

(3) Paragraph (2) shall not apply if the employee files a false or fraudulent withholding exemption certificate for the taxable year, or the taxpayer provides a false or fraudulent document or documents to obtain reduced withholding at source for the taxable year.

(e) Section 6654(f) of the Internal Revenue Code shall not apply and for purposes of this section the term ''tax'' means the tax imposed

under Section 17041 or 17048, less any credits against the tax provided by Part 10 (commencing with Section 17001) or this part, other than the credit provided by subdivision (a) of Section 19002.

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

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

(h) No addition to tax shall be made under this section for any period before April 16, 1999, with respect to any underpayment of an installment for the 1998 taxable year, to the extent that the underpayment was created or increased as the result of a distribution to which Section 408A(d)(3) of the Internal Revenue Code, relating to rollovers from an IRA other than a Roth IRA, applies.

SEC. 53. Section 19136.6 is added to the Revenue and Taxation Code, to read:

19136.6. (a) No addition to tax shall be made under Section 19136 for any period before April 16, 1999, with respect to any underpayment of an installment for the 1998 taxable year, to the extent that the underpayment was created or increased by the act adding this section.

(b) No addition to tax shall be made under Section 19142 for any period before April 16, 1999, with respect to any underpayment of an installment for the 1998 income year, to the extent that the underpayment was created or increased by the act adding this section.

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

SEC. 54. Section 19141.2 of the Revenue and Taxation Code is amended to read:

19141.2. (a) Section 6038 of the Internal Revenue Code, relating to information with respect to certain foreign corporations, shall apply, except as otherwise provided.

(b) Section 6038(a) is modified as follows:

(1) The information required to be filed with the Franchise Tax Board under this section shall be a copy of the information required to be filed with the Internal Revenue Service.

(2) The term ''United States person,'' as defined in Section 7701(a)(30) of the Internal Revenue Code, shall be limited to a domestic corporation, as defined in Section 7701(a) of the Internal Revenue Code, or a bank, as defined in Section 23039, that is subject to the tax imposed under Chapter 2 (commencing with Section 23101), Chapter 2.5 (commencing with Section 23400), or Chapter 3 (commencing with Section 23501), of Part 11.

(c) (1) Unless it is shown that the failure is due to reasonable cause and not due to willful neglect, a penalty shall be imposed under this part for failure to furnish information and that penalty shall be

determined in accordance with Section 6038 of the Internal Revenue Code, except as otherwise provided.

(A) Section 6038(b) of the Internal Revenue Code shall be modified by substituting ''$1,000'' for ''$10,000'' in each place it appears.

(B) Section 6038(b)(2) of the Internal Revenue Code shall be modified by substituting ''$24,000'' for ''$50,000.''

(2) No penalty shall be imposed under paragraph (1) if the copy of the information required to be filed with the Internal Revenue Service was not attached to the taxpayer's return as originally filed but the taxpayer does both of the following:

(A) Furnishes the copy of the information required to be filed with the Internal Revenue Service either upon its own initiative or within 90 days of notification by the Franchise Tax Board of the requirements of this section.

(B) Agrees to attach a copy of the information required to be filed with the Internal Revenue Service to the taxpayer's original return filed for subsequent income years.

(3) All or any portion of the penalty imposed under paragraph (1) may be waived by the Franchise Tax Board when the taxpayer has entered into a voluntary disclosure agreement under Article 8 (commencing with Section 19191) of Chapter 4.

(4) The penalty imposed under this subdivision shall not apply to returns required to be filed for income years beginning before January 1, 1998.

(d) This section shall apply to returns required to be filed for income years beginning on or after January 1, 1997.

SEC. 55. Section 19141.5 of the Revenue and Taxation Code is amended to read:

19141.5. (a) (1) Section 6038A of the Internal Revenue Code, relating to information with respect to certain foreign-owned corporations, shall apply.

(2) A penalty shall be imposed under this part for failure to furnish information or maintain records and that penalty shall be determined in accordance with Section 6038A of the Internal Revenue Code.

(3) Section 11314 of Public Law 101-508, relating to application of amendments made by Section 7403 of the Revenue Reconciliation Act of 1989 to taxable years beginning on or before July 10, 1989, shall apply.

(4) Section 6038A(e) of the Internal Revenue Code, relating to enforcement of requests for certain records, is modified as follows:

(A) Each reference to Section 7602, 7603, or 7604 of the Internal Revenue Code shall instead refer to Section 19504.

(B) Each reference to ''summons'' shall instead refer to ''subpoena duces tecum.''

(C) Section 6038A(e)(4)(C) of the Internal Revenue Code shall refer to ''superior courts of the State of California for the Counties of Los Angeles, Sacramento, and San Diego, and for the City and County of San Francisco,'' instead of ''United States district court for the district in which the person (to whom the summons is issued) resides or is found.''

(b) In the case of a corporation, each of the following shall apply:

(1) Section 6038B of the Internal Revenue Code, relating to notice of certain transfers to foreign persons, shall apply, except as otherwise provided.

(2) The information required to be filed with the Franchise Tax Board under this subdivision shall be a copy of the information required to be filed with the Internal Revenue Service.

(3) (A) A penalty shall be imposed under this part for failure to furnish information and that penalty shall be determined in accordance with Section 6038B of the Internal Revenue Code, except as otherwise provided.

(B) Subparagraph (A) shall not apply to any transfer described in Section 6038B(a)(1)(B) of the Internal Revenue Code.

(c) (1) Section 6038C of the Internal Revenue Code, relating to information with respect to foreign corporations engaged in United States business, shall apply.

(2) A penalty shall be imposed under this part for failure to furnish information or maintain records and that penalty shall be determined in accordance with Section 6038C of the Internal Revenue Code.

(3) Section 6038C(d) of the Internal Revenue Code, relating to enforcement of requests for certain records, is modified as follows:

(A) Each reference to Section 7602, 7603, or 7604 of the Internal Revenue Code shall instead refer to Section 19504.

(B) Each reference to ''summons'' shall instead refer to ''subpoena duces tecum.''

(d) For purposes of this part, the information required to be filed with the Franchise Tax Board pursuant to this section shall be a copy of the information filed with the Internal Revenue Service.

(e) For purposes of this section, each of the following shall apply:

(1) Section 7701(a)(4) of the Internal Revenue Code, relating to the term ''domestic,'' shall apply.

(2) Section 7701(a)(5) of the Internal Revenue Code, relating to the term ''foreign,'' shall apply.

(3) Section 7701(a)(30) of the Internal Revenue Code, relating to the term ''United States person,'' shall apply. However, the term ''United States person'' shall not include any corporation that is not subject to the tax imposed under Chapter 2 (commencing with Section 23101), Chapter 2.5 (commencing with Section 23400), or Chapter 3 (commencing with Section 23501), of Part 11.

SEC. 56. 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 18547 and the penalty amount shall be determined in accordance with Section 6707 of the Internal Revenue Code.

(b) If the person required to register the tax shelter has complied, for federal purposes, with the requirements of Section 6111(d) of the Internal Revenue Code, relating to certain confidential arrangements treated as tax shelters, the person required to register the tax shelter shall be deemed to have complied with the requirements of Section 18547 for purposes of this part and no penalty shall be imposed under subdivision (a).

(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. 57. Section 19184 of the Revenue and Taxation Code, as amended by Chapter 7 of the Statutes of 1998, 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 education individual retirement 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. 58. Section 19521 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

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

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

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

SEC. 59. Section 19524 of the Revenue and Taxation Code is amended to read:

19524. (a) The Franchise Tax Board shall prescribe regulations providing standards for determining which returns shall be filed on magnetic media or in other machine-readable form. The Franchise Tax Board shall not require returns of any tax imposed by Part 10 (commencing with Section 17001) on individuals, estates, and trusts to be other than on paper forms supplied by the Franchise Tax Board.

In prescribing those regulations, the Franchise Tax Board shall take into account, among other relevant factors, the ability of the taxpayer to comply at a reasonable cost with that filing requirement.

(b) (1) Subdivision (a) is applicable only to taxpayers required to file returns on magnetic media or in other machine-readable form pursuant to Section 6011(e) of the Internal Revenue Code and the regulations adopted thereto.

(2) For purposes of paragraph (1), the last sentence of Section 6011(e)(2) of the Internal Revenue Code, shall not apply.

(3) In addition, the regulations under subdivision (a) shall not require that returns filed on magnetic media or in other machine-readable form contain more information than is required to be included in similar returns filed with the Internal Revenue Service under Section 6011(e) of the United States Internal Revenue Code and the regulations adopted thereto.

(c) In lieu of the magnetic media or other machine-readable form returns required by this section, a copy of the similar magnetic media or other machine-readable form returns filed with the Internal Revenue Service pursuant to Section 6011(e) of the Internal Revenue Code, and the regulations adopted thereto, may be filed with the Franchise Tax Board.

SEC. 60. Section 19721.6 of the Revenue and Taxation Code is amended and renumbered to read:

19271.6. (a) The Franchise Tax Board, through a cooperative agreement with the State Department of Social Services, and in coordination with financial institutions doing business in this state, shall operate a Financial Institution Match System utilizing automated data exchanges to the maximum extent feasible. The Financial Institution Match System shall be implemented pursuant to guidelines prescribed by the State Department of Social Services and the Franchise Tax Board. These guidelines shall include a structure by which financial institutions, or their designated data processing agents, shall receive from the Franchise Tax Board the entire list of past-due support obligors, which the institution shall match with its own list of accountholders to identify past-due support obligor accountholders at the institution. To the extent allowed by the federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996, the guidelines shall include an option by which financial institutions without the technical ability to process the data exchange, or without the ability to employ a third-party data processor to process the data exchange, may forward to the Franchise Tax Board a list of all accountholders and their social security numbers, so that the Franchise Tax Board shall match that list with the entire list of past-due support obligors.

(b) The Financial Institution Match System shall not be subject to any limitation set forth in Chapter 20 (commencing with Section 7460) of Division 7 of Title 1 of the Government Code. However, any

use of the information provided pursuant to this section for any purpose other than the enforcement and collection of a child support delinquency, as set forth in Section 19271, shall be a violation of Section 19542.

(c) Each county shall compile a file of support obligors with judgments and orders that are being enforced by district attorneys pursuant to Section 11475.1 of the Welfare and Institutions Code, and who are past due in the payment of their support obligations. The file shall be compiled, updated, and forwarded to the Franchise Tax Board, in accordance with the guidelines prescribed by the State Department of Social Services and the Franchise Tax Board.

(d) To effectuate the Financial Institution Match System, financial institutions subject to this section shall do all of the following:

(1) Provide to the Franchise Tax Board on a quarterly basis the name, record address and other addresses, social security number or other taxpayer identification number, and other identifying information for each noncustodial parent who maintains an account at the institution and who owes past-due support, as identified by the Franchise Tax Board by name and social security number or other taxpayer identification number.

(2) In response to a notice or order to withhold issued by the Franchise Tax Board, withhold from any accounts of the obligor the amount of any past-due support stated on the notice or order and transmit the amount to the Franchise Tax Board in accordance with Section 18670 or 18670.5.

(e) Unless otherwise required by applicable law, a financial institution furnishing a report or providing information to the Franchise Tax Board pursuant to this section shall not disclose to a depositor or an accountholder, or a codepositor or coaccountholder, that the name, address, social security number, or other taxpayer identification number or other identifying information of that person has been received from or furnished to the Franchise Tax Board.

(f) A financial institution shall incur no obligation or liability to any person arising from any of the following:

(1) Furnishing information to the Franchise Tax Board as required by this section.

(2) Failing to disclose to a depositor or accountholder that the name, address, social security number, or other taxpayer identification number or other identifying information of that person was included in the data exchange with the Franchise Tax Board required by this section.

(3) Withholding or transmitting any assets in response to a notice or order to withhold issued by the Franchise Tax Board as a result of the data exchange. This paragraph shall not preclude any liability that may result if the financial institution does not comply with subdivision (b) of Section 18674.

(4) Any other action taken in good faith to comply with the requirements of this section.

(g) Information required to be submitted to the Franchise Tax Board pursuant to this section shall only be used by the Franchise Tax Board to collect past-due support pursuant to Section 19271. If the Franchise Tax Board has issued an earnings withholding order and the condition described in subparagraph (C) of paragraph (1) of subdivision (i) exists with respect to the obligor, the Franchise Tax Board shall not use the information it receives under this section to collect the past-due support from that obligor. The Franchise Tax Board shall forward to the counties, in accordance with guidelines prescribed by the State Department of Social Services and the Franchise Tax Board, information obtained from the financial institutions pursuant to this section. No county shall use this information for directly levying on any account. Each county shall keep the information confidential as provided by Section 11478.1 of the Welfare and Institutions Code.

(h) For those noncustodial parents owing past-due support for which there is a match under paragraph (1) of subdivision (d), the past-due support at the time of the match shall be a delinquency under this article for the purposes of the Franchise Tax Board taking any collection action pursuant to Section 18670 or 18670.5.

(i) (1) Each county shall notify the Franchise Tax Board upon the occurrence of the circumstances described in the following subparagraphs with respect to an obligor of past-due support:

(A) All of the following apply:

(i) A court has ordered an obligor to make scheduled payments on a child support arrearages obligation.

(ii) The obligor is in compliance with that order.

(B) An earnings assignment order or a notice of assignment that includes an amount for past-due support has been served on the obligated parent’s employer and earnings are being withheld pursuant to the earnings assignment order or a notice of assignment.

(C) At least 50 percent of the obligated parent’s earnings are being withheld for support.

(D) The obligor is less than 90 days delinquent in the payment of any amount of support. For purposes of this subparagraph, any delinquency existing at the time a case is received by a district attorney shall not be considered until 90 days have passed.

(E) A child support delinquency need not be referred to the Franchise Tax Board for collection if a jurisdiction outside this state is enforcing the support order.

(2) Upon notification, the Franchise Tax Board shall not use the information it receives under this section to collect any past-due support from that obligor.

(j) Notwithstanding subdivision (i), the Franchise Tax Board may use the information it receives under this section to collect any past-due support at any time if a county requests action be taken.

(k) The Franchise Tax Board may not use the information it receives under this section to collect any past-due support if a county has applied for and received an exemption from the State Department of Social Services as provided by subdivision (k) of Section 19271, unless that county specifically requests collection against that obligor. The Franchise Tax Board may not use the information it receives under this section to collect any past-due support if a county requests that action not be taken.

(*l*) For purposes of this section:

(1) ''Account'' means any demand deposit account, share or share draft account, checking or negotiable withdrawal order account, savings account, time deposit account, or a money market mutual fund account, whether or not the account bears interest.

(2) ''Financial institution'' has the same meaning as defined in Section 669A(d)(1) of Title 42 of the United States Code.

(3) ''Past-due support'' means any child support obligation that is unpaid on the due date for payment.

(m) Out of any money received from the federal government for the purpose of reimbursing financial institutions for their actual and reasonable costs incurred in complying with this section, the state shall reimburse those institutions. To the extent that money is not provided by the federal government for that purpose, the state shall not reimburse financial institutions for their costs in complying with this section.

(n) By March 1, 1998, the Franchise Tax Board and the Department of Social Services, in consultation with counties and financial institutions, shall jointly propose an implementation plan for inclusion in the annual Budget Act, or in other legislation that would fund this program. The implementation plan shall take into account the program's financial benefits, including the costs of all participating private and public agencies. It is the intent of the Legislature that this program shall result in a net savings to the state and the counties.

SEC. 61. Section 20514 of the Revenue and Taxation Code is amended to read:

20514. (a) Assistance shall not be allowed under this chapter if gross household income, after allowance for actual cash expenditures that are reasonable, ordinary, and necessary to realize income, exceeds twenty-four thousand dollars ($24,000).

(b) With respect to assistance that is provided by the Franchise Tax Board pursuant to this chapter for the 1999 calendar year, the gross household income figure set forth in subdivision (a) shall be multiplied by a factor of 2.51.

(c) With respect to assistance that is provided by the Franchise Tax Board pursuant to this chapter for the 2000 calendar year and each calendar year thereafter, the gross household income figure that applies to assistance provided by the Franchise Tax Board during that period shall be the gross household income figure that applied to assistance provided by the Franchise Tax Board in the same period in the immediately preceding year, multiplied by an inflation adjustment factor calculated as follows:

(1) On or before February 1 of each year, the Department of Industrial Relations shall transmit to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the second preceding calendar year to June of the immediately preceding calendar year.

(2) The Franchise Tax Board shall add 100 percent to the percentage change figure that is furnished pursuant to paragraph (1) and divide the result by 100.

(3) The Franchise Tax Board shall multiply the gross household income figure that applies in the immediately preceding year by the inflation adjustment factor determined in paragraph (2), and round off the resulting product to the nearest one dollar ($1).

SEC. 62. Section 20543 of the Revenue and Taxation Code is amended to read:

20543. (a) (1) The amount of assistance for a claimant owning his or her residential dwelling shall be based on claimant's household income for the period set forth in Section 20503.

(2) The percentage of assistance for which each claimant owning his or her residential dwelling shall be eligible shall be based on the following scale:

If the total household income (as defined in this part) is not more than:	The percentage of tax on the first $34,000 of full value (as determined for tax purposes) used to provide assistance is:
$3,300	96%
3,520	94
3,740	92
3,960	90
4,180	88
4,400	86
4,620	84
4,840	82
5,060	80
5,280	78
5,500	76

5,720	73
5,940	69
6,160	65
6,380	61
6,600	57
6,820	53
7,040	49
7,260	45
7,480	41
7,700	37
7,920	34
8,140	31
8,360	28
8,580	25
8,800	22
9,020	20
9,240	18
9,460	16
9,680	14
9,900	12
10,450	10
11,000	8
11,550	7
12,100	6
12,650	5
13,200	4

(b) With respect to assistance that is provided by the Franchise Tax Board pursuant to this chapter for the 1999 calendar year, the household income figures set forth in paragraph (2) of subdivision (a) shall be multiplied by a factor of 2.51.

(c) With respect to assistance that is provided by the Franchise Tax Board pursuant to this chapter for the 2000 calendar year and each year thereafter, the household income figures that apply to assistance provided by the Franchise Tax Board during that period shall be the household income figures that applied to assistance provided by the Franchise Tax Board in the same period in the immediately preceding year, multiplied by an inflation factor calculated as follows:

(1) On or before February 1 of each year, the Department of Industrial Relations shall transmit to the Franchise Tax Board the percentage change in the California Consumer Price Index for all

items from June of the second preceding calendar year to June of the immediately preceding calendar year.

(2) The Franchise Tax Board shall add 100 percent to the percentage change figure that is furnished pursuant to paragraph (1) and divide the result by 100.

(3) The Franchise Tax Board shall multiply the immediately preceding household income figure by the inflation adjustment factor determined in paragraph (2), and round off the resulting product to the nearest one dollar ($1).

SEC. 63. Section 20544 of the Revenue and Taxation Code is amended to read:

20544. (a) (1) The amount of assistance for a claimant renting his or her residence shall be based on the claimant's household income for the time period set forth in Section 20503.

(2) The percentage of assistance for which each claimant renting his or her residence shall be eligible shall be based on the following scale:

If the total household income (as defined in this part) is not more than:	The statutory property tax equivalent is:	The percentage of the statutory property tax equivalent used to provide assistance is:
$3,300	$250	96%
3,520	250	94
3,740	250	92
3,960	250	90
4,180	250	88
4,400	250	86
4,620	250	84
4,840	250	82
5,060	250	80
5,280	250	78
5,500	250	76
5,720	250	73
5,940	250	69
6,160	250	65
6,380	250	61
6,600	250	57
6,820	250	53
7,040	250	49
7,260	250	45
7,480	250	41
7,700	250	37

7,920	250	34
8,140	250	31
8,360	250	28
8,580	250	25
8,800	250	22
9,020	250	20
9,240	250	18
9,460	250	16
9,680	250	14
9,900	250	12
10,450	250	10
11,000	250	8
11,550	250	7
12,100	250	6
12,600	250	5
13,200	250	4

(b) With respect to assistance that is provided by the Franchise Tax Board pursuant to this chapter for the 1999 calendar year, the household income figures set forth in paragraph (2) of subdivision (a) shall be multiplied by a factor of 2.51.

(c) With respect to assistance that is provided by the Franchise Tax Board pursuant to this chapter for the 2000 calendar year and each year thereafter, the household income figures that apply to assistance provided by the Franchise Tax Board during that period shall be the household income figures that applied to assistance provided by the Franchise Tax Board in the same period in the immediately preceding year, multiplied by an inflation factor calculated as follows:

(1) On or before February 1 of each year, the Department of Industrial Relations shall transmit to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the second preceding calendar year to June of the immediately preceding calendar year.

(2) The Franchise Tax Board shall add 100 percent to the percentage change figure that is furnished pursuant to paragraph (1) and divide the result by 100.

(3) The Franchise Tax Board shall multiply the immediately preceding household income figure by the inflation adjustment factor determined in paragraph (2), and round off the resulting product to the nearest one dollar ($1).

SEC. 64. Section 23455.5 is added to the Revenue and Taxation Code, to read:

23455.5. Section 55(e) of the Internal Revenue Code, relating to exemption for small corporations, shall not apply.

SEC. 65. Section 23456 of the Revenue and Taxation Code, as amended by Chapter 7 of the Statutes of 1998, is amended to read:

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

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

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

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

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

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

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

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

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

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

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

(1) Sections 56(g)(1)(A) and 56(g)(3) of the Internal Revenue Code are modified to provide that the term ''adjusted current earnings'' means the sum of the adjusted current earnings of that

corporation apportionable to this state and the adjusted current earnings allocable to this state.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(h) Section 56(g)(4)(I) of the Internal Revenue Code, relating to treatment of charitable contributions, shall not apply.

SEC. 66. Section 23636 is added to the Revenue and Taxation Code, to read:

23636. (a) For each income year beginning on or after January 1, 2001, and before January 1, 2006, a qualified taxpayer shall be allowed as a credit against the ''tax,'' as defined in Section 23036, an amount equal to the following:

(1) Fifty percent of qualified wages paid or incurred during any income year beginning on or after January 1, 2001, and before January 1, 2002.

(2) Forty percent of qualified wages paid or incurred during any income year beginning on or after January 1, 2002, and before January 1, 2003.

(3) Thirty percent of the qualified wages paid or incurred during any income year beginning on or after January 1, 2003, and before January 1, 2004.

(4) Twenty percent of the qualified wages paid or incurred during any income year beginning on or after January 1, 2004, and before January 1, 2005.

(5) Ten percent of the qualified wages paid or incurred during any income year beginning on or after January 1, 2005, and before January 1, 2006.

(b) For purposes of this section:

(1) (A) ‘‘Qualified taxpayer’’ means any taxpayer under an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter.

(B) In the case of any pass-through entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 17053.36 shall be allowed to the pass-through entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or this part. For purposes of this paragraph, ‘‘pass-through entity’’ means any partnership or S corporation.

(2) ‘‘Qualified wages’’ means that portion of wages paid or incurred by the qualified taxpayer during the income year with respect to qualified employees that are direct costs as defined in Section 263A of the Internal Revenue Code allocable to property manufactured in this state by the qualified taxpayer for ultimate use in a Joint Strike Fighter.

(3) ‘‘Qualified employee’’ means an individual whose services for the qualified taxpayer are performed in this state and are at least 90 percent directly related to the qualified taxpayer’s contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter.

(4) ‘‘Joint Strike Fighter’’ means the next generation air combat strike aircraft developed and produced under the Joint Strike Fighter program.

(5) ‘‘Joint Strike Fighter program’’ means the multiservice, multinational project conducted by the United States government to develop and produce the next generation of air combat strike aircraft.

(c) The credit allowed by this section shall not exceed ten thousand dollars ($10,000) per year, per qualified employee. For employees that are qualified employees for part of an income year, the credit shall not exceed ten thousand dollars ($10,000) multiplied by a fraction, the numerator of which is the number of months of the income year that the employee is a qualified employee and the denominator of which is 12.

(d) 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 seven succeeding years if necessary, until the credit is exhausted.

(e) No credit shall be allowed unless the credit is reflected within the bid upon which the qualified taxpayer’s contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter is based by reducing the amount of the bid by the amount of the credit allowable.

(f) All references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a contract or

subcontract and for which a qualified taxpayer is making a claim shall be made available to the Franchise Tax Board upon request.

(g) This section shall remain in effect only until December 1, 2006, and as of that date is repealed.

SEC. 67. Section 23637 is added to the Revenue and Taxation Code, to read:

23637. (a) For each income year beginning on or after January 1, 2001, and before January 1, 2006, a qualified taxpayer shall be allowed as a credit against the ''tax,'' as defined in Section 23036, an amount equal to 10 percent of the qualified cost of qualified property that is placed in service in this state.

(b) (1) For purposes of this section, ''qualified cost'' means any costs that satisfy each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2001, and before January 1, 2006. In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or before January 1, 2001, costs paid pursuant to that contract shall be subject to allocation as follows. Contract costs shall be allocated to qualified property based on a ratio of costs actually paid prior to January 1, 2001, and total contract costs actually paid. ''Cost paid'' shall include, without limitation, contractual deposits and option payments. To the extent of costs allocated, whether or not currently deductible or depreciable for tax purposes, to a period prior to January 1, 2001, the cost shall be deemed allocated to property acquired before January 1, 2001, and is thus not a ''qualified cost.''

(B) Except as provided in paragraph (2) of subdivision (d), is an amount upon which the qualified taxpayer has paid, directly or indirectly, as a separately stated contract amount or as determined from the records of the qualified taxpayer, sales or use tax under Part 1 (commencing with Section 6001).

(C) Is an amount properly chargeable to the capital account of the qualified taxpayer.

(2) (A) For purposes of this subdivision, any contract entered into on or after January 1, 2001, that is a successor or replacement contract to a contract that was binding before January 1, 2001, shall be treated as a binding contract in existence before January 1, 2001.

(B) If a successor or replacement contract is entered into on or after January 1, 2001, and the subject of the successor or replacement contract relates both to amounts for the construction, reconstruction, or acquisition of qualified property described in the original binding contract and to costs for the construction, reconstruction, or acquisition of qualified property not described in the original binding

contract, then the portion of those amounts described in the successor or replacement contract that were not described in the original binding contract shall not be treated as costs paid or incurred pursuant to a binding contract in existence on or prior to January 1, 2001, under subparagraph (A) of paragraph (1).

(3) (A) For purposes of this section, an option contract in existence before January 1, 2001, under which a qualified taxpayer (or any other person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) had an option to acquire qualified property, shall be treated as a binding contract under the rules in paragraph (2). For purposes of this subparagraph, an option contract shall not include an option under which the optionholder will forfeit an amount less than 10 percent of the fixed option price in the event the option is not exercised.

(B) For purposes of this section, a contract shall be treated as binding even if the contract is subject to a condition.

(c) (1) For purposes of this section, ''qualified taxpayer'' means any taxpayer under an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter.

(2) In the case of any pass-through entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 17053.37 shall be allowed to the pass-through entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term ''pass-through entity'' means any partnership or S corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) (1) For purposes of this section, ''qualified property'' means property that is described as either of the following:

(A) Tangible personal property that is defined in Section 1245(a)(3)(A) of the Internal Revenue Code for use by a qualified taxpayer primarily in qualified activities to manufacture a product for ultimate use in a Joint Strike Fighter.

(B) The value of any capitalized labor costs that are direct costs as defined in Section 263A of the Internal Revenue Code allocable to the construction or modification of property described in subparagraph (A).

(2) Qualified property does not include any of the following:

(A) Furniture.

(B) Inventory.

(C) Equipment used to store finished products that have completed the manufacturing process.

(D) Any tangible personal property that is used in administration, general management, or marketing.

(e) For purposes of this section:

(1) ''Fabricating'' means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(2) ''Joint Strike Fighter'' means the next generation air combat strike aircraft developed and produced under the Joint Strike Fighter program.

(3) ''Joint Strike Fighter program'' means the multiservice, multinational project conducted by the United States government to develop and produce the next generation of air combat strike aircraft.

(4) ''Manufacturing'' means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate use in a Joint Strike Fighter. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(5) ''Primarily'' means tangible personal property used 50 percent or more of the time in an activity described in subparagraph (A) of paragraph (1) of subdivision (d).

(6) ''Process'' means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, or fabricating activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, or fabricating activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer's manufacturing, processing, or fabricating activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer's manufacturing, processing, or fabricating activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, or fabricating process.

(7) ''Processing'' means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) ''Qualified activities'' means manufacturing, processing, or fabricating of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing,

processing, or fabricating has altered tangible personal property to its completed form, including packaging, if required.

(f) The credit allowed under subdivision (a) shall apply to qualified property that is acquired by or subject to lease by a qualified taxpayer, subject to the following special rules:

(1) A lessor of qualified property, irrespective of whether the lessor is a qualified taxpayer, shall not be allowed the credit provided under subdivision (a) with respect to any qualified property leased to another qualified taxpayer.

(2) For purposes of paragraphs (2) and (3) of subdivision (b), ''binding contract'' includes any lease agreement with respect to the qualified property.

(3) (A) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is not treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(i) Except as provided by subparagraph (C) of this paragraph, subparagraphs (A) and (C) of paragraph (1) of subdivision (b) shall not apply.

(ii) Except as provided in subparagraph (B) and clause (iii), the ''qualified cost'' upon which the lessee shall compute the credit provided under this section shall be equal to the original cost to the lessor (within the meaning of Section 18031) of the qualified property that is the subject of the lease.

(iii) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied only if the lessor has made a timely election under either Section 6094.1 or subdivision (d) of Section 6244 and has paid sales tax reimbursement or use tax measured by the purchase price of the qualified property (within the meaning of paragraph (5) of subdivision (g) of Section 6006). For purposes of this subdivision, the amount of original cost to the lessor which may be taken into account under clause (ii) shall not exceed the purchase price upon which sales tax reimbursement or use tax has been paid under the preceding sentence.

(B) For purposes of applying subparagraph (A) only, the following special rules shall apply:

(i) The original cost to the lessor of the qualified property shall be reduced by the amount of any original cost of that property that was taken into account by a predecessor lessee in computing the credit allowable under this section.

(ii) Clause (i) shall not apply in any case where the predecessor lessee was required to recapture the credit provided under this section pursuant to the provisions of subdivision (g).

(iii) For purposes of this section only, in any case where a successor lessor has acquired qualified property from a predecessor lessor in a transaction not treated as a sale under Part 1 (commencing with Section 6001), the original cost to the successor lessor of the

qualified property shall be reduced by the amount of the original cost of the qualified property that was taken into account by any lessee of the predecessor lessor in computing the credit allowable under this section.

(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 2001, and before January 1, 2006, shall be taken into account. In the case of any qualified property constructed, reconstructed, or acquired by a lessor pursuant to a binding contract in existence on or prior to January 1, 2001, the allocation rule specified in subparagraph (A) of paragraph (1) of subdivision (b) shall apply in determining the original cost to the lessor of qualified property.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any party related to the lessee within the meaning of Section 267 or 318 of the Internal Revenue Code) acquires the qualified property from the lessor (or any successor lessor) within one year from the date the qualified property is first used by the lessee under the terms of the lease, the lessee's (or related party's) acquisition of the qualified property from the lessor (or successor lessor) shall be treated as a disposition by the lessee of the qualified property that was subject to the lease under subdivision (g).

(4) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(A) Subparagraph (A) of paragraph (1) of subdivision (b) shall be applied by substituting the term ''purchase'' for the term ''construction, reconstruction, or acquisition.''

(B) Subparagraph (C) of paragraph (1) of subdivision (b) shall apply.

(C) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied at the time that either the lessor or the qualified taxpayer pays sales or use tax under Part 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's income year in which the credit is allowable to the lessee under this section.

(B) The statement required under subparagraph (A) shall be made available to the Franchise Tax Board upon request.

(g) No credit shall be allowed if the qualified property is removed from the state, is disposed of to an unrelated party, or is used for any purpose not qualifying for the credit provided in this section in the

same income year in which the taxpayer first places the qualified property in service in this state. If any qualified property for which a credit is allowed pursuant to this section is thereafter removed from this state, disposed of to an unrelated party, or used for any purpose not qualifying for the credit provided in this section within one year from the date the taxpayer first places the qualified property in service in this state, the amount of the credit allowed by this section for that qualified property shall be recaptured by adding that credit amount to the tax of the qualified taxpayer for the income year in which the qualified property is disposed of, removed, or put to an ineligible use.

(h) 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 seven succeeding years if necessary, until the credit is exhausted.

(i) (1) No credit shall be allowed under this section if a credit is claimed under Section 23649 in connection with the same property.

(2) No credit shall be allowed unless the credit is reflected within the bid upon which the qualified taxpayer's contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter is based by reducing the amount of the bid by the amount of the credit allowable.

(j) All references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a contract or subcontract and for which a qualified taxpayer is making a claim shall be made available to the Franchise Tax Board upon request.

(k) This section shall remain in effect only until December 1, 2006, and as of that date is repealed.

SEC. 68. Section 23701t of the Revenue and Taxation Code is amended to read:

23701t. (a) A homeowners' association organized and operated to provide for the acquisition, construction, management, maintenance, and care of residential association property if all of the following apply:

(1) Sixty percent or more of the gross income of such organization for the taxable year consists solely of amounts received as membership dues, fees and assessments from either of the following:

(A) Tenant-stockholders or owners of residential units, residences or lots.

(B) Owners of timeshare rights to use, or timeshare ownership interests in, association property in the case of a timeshare association.

(2) Ninety percent or more of the expenditures of the organization for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property and, in the case of a timeshare association, for activities provided to or on behalf of members of the association.

(3) No part of the net earnings inures (other than by providing management, maintenance and care of association property or by a rebate of excess membership dues, fees or assessments) to the benefit of any private shareholder or individual.

(4) Amounts received as membership dues, fees and assessments not expended for association purposes during the taxable year are transferred to and held in trust to provide for the management, maintenance, and care of association property and common areas.

(b) The term ''association property'' means—

(1) Property held by the organization,

(2) Property held in common by the members of the organization, and

(3) Property within the organization privately held by the members of the organization.

In the case of a timeshare association, ''association property'' includes property in which the timeshare association, or members of the association, have rights arising out of recorded easements, covenants, or other recorded instruments to use property related to the timeshare project.

(c) A homeowners' association shall be subject to tax under this part with respect to its ''homeowners' association taxable income,'' and such income shall be subject to tax as provided by Chapter 3 (commencing with Section 23501) of this part.

(1) For purposes of this section, the term ''homeowners' association taxable income'' of any organization for any taxable year means an amount equal to the excess over one hundred dollars ($100) (if any) of—

(A) The gross income for the taxable year (excluding any exempt function income), over

(B) The deductions allowed by this part which are directly connected with the production of the gross income (excluding exempt function income).

(2) For purposes of this section, the term ''exempt function income'' means any amount received as membership fees, dues and assessments from tenant-shareholders or owners of residential units, residences or lots, or owners of timeshare rights to use, or timeshare ownership interests in, association property in the case of a timeshare association.

(d) The term ''homeowners' association'' includes a condominium management association, a residential real estate management association, a timeshare association, and a cooperative housing corporation.

(e) ''Cooperative housing corporation'' includes, but is not limited to, a limited-equity housing cooperative, as defined in Section 33007.5 of the Health and Safety Code, organized either as a nonprofit public benefit corporation pursuant to Part 2 (commencing with Section 5110) of Division 2 of Title 1 of the Corporations Code, or a nonprofit

mutual benefit corporation pursuant to Part 3 (commencing with Section 7110) of Division 2 of Title 1 of the Corporations Code.

(f) The term ‘‘timeshare association’’ means any organization (other than a condominium management association) organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property if any member thereof holds a timeshare right to use, or a timeshare ownership interest in, real property constituting association property.

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

SEC. 69. Section 23704 of the Revenue and Taxation Code is amended to read:

23704. For purposes of this part, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if:

(a) The organization is organized and operated solely:

(1) To perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in Section 23701d and exempt from taxation under Section 23701, would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group basis), warehousing, billing and collection (including the purchase of patron accounts receivable on a recourse basis), food, clinical, industrial engineering, laboratory, laundry, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(2) To perform such services solely for two or more hospitals, and for no other individuals or organizations, each of which is:

(A) An organization described in Section 23701d which is exempt from taxation under Section 23701;

(B) A constituent part of an organization described in Section 23701d which is exempt from taxation under Section 23701 and which, if organized and operated as a separate entity, would constitute an organization described in Section 23701d; or

(C) Owned and operated by the United States, the state, a county, or political subdivision, or an agency or instrumentality of any of the foregoing;

(b) The organization is organized and operated on a cooperative basis and allocates or pays, within $8^{1}/_{2}$ months after the close of its income year, all net earnings to members on the basis of services performed for them; and

(c) If the organization has capital stock, all of that stock outstanding is owned by its members.

For purposes of this part, any organization which, by reason of the preceding sentence, is an organization described in Section 23701d and exempt from taxation under Section 23701, shall be treated as a hospital and as an organization referred to in Section 23736(e).

SEC. 70. Section 23704.3 is added to the Revenue and Taxation Code, to read:

23704.3. An organization shall not fail to be treated as organized and operated exclusively for a charitable purpose for purposes of Section 23701d solely because a hospital that is owned and operated by the organization participates in a provider-sponsored organization, as defined in Section 1853(e) of the Social Security Act, whether or not the provider-sponsored organization is exempt from tax. For purposes of Section 23701d, any person with a material financial interest in such a provider-sponsored organization shall be treated as a private shareholder or individual with respect to the hospital.

SEC. 71. Section 23711 is added to the Revenue and Taxation Code, 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. 72. Section 23712 of the Revenue and Taxation Code is amended to read:

23712. Section 530 of the Internal Revenue Code, relating to education individual retirement accounts, shall apply, except as otherwise provided.

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

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

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

(b) Section 530(b)(1) of the Internal Revenue Code, relating to the definition of education individual retirement account, is modified to additionally require that upon the date that the designated

beneficiary becomes 30 years of age, any balance to the credit of the beneficiary shall be distributed within 30 days after the date the beneficiary becomes 30 years of age to that beneficiary.

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

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

(2) (A) A taxpayer that has elected to waive the application of Section 530(d)(2) of the Internal Revenue Code for federal purposes shall be treated as having waived the application of that paragraph for state purposes, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5 or paragraph (3) of subdivision (e) of Section 23051.5, and the federal election shall be binding for purposes of Part 10 (commencing with Section 17001) and this part.

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

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

(B) By substituting the phrase ''increased by $2^1/_2$ percent'' in lieu of the phrase ''increased by 10 percent'' in Section 530(d)(4)(A) of the Internal Revenue Code.

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

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

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

SEC. 73. Section 23771 of the Revenue and Taxation Code is amended to read:

23771. (a) Except as provided in subdivision (b), every organization, otherwise exempt under Article 1 (commencing with Section 23701), but having income of the character described in Article 2 (commencing with Section 23731), shall file a return, verified by an executive officer under penalty of perjury in the form prescribed by the Franchise Tax Board, on or before the 15th day of the fifth month following the close of the income year, reporting its income from those activities and shall pay a tax as required by Section 23731 on its unrelated business taxable income as defined in Section 23732.

(b) An education IRA described in Section 23712 shall file a return described in subdivision (a) on or before the 15th day of the fourth month following the close of the income year.

SEC. 74. Section 23800.5 of the Revenue and Taxation Code, as amended by Chapter 7 of the Statutes of 1998, is amended to read:

23800.5. (a) Section 1361(b)(2)(A) of the Internal Revenue Code, relating to ineligible corporation defined, shall not apply and in lieu thereof, for purposes of Section 1361(b)(1) of the Internal Revenue Code, Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part, ''ineligible corporation'' shall include a savings and loan association, bank, or financial corporation which uses the reserve method of accounting for bad debts described in Section 24348.

(b) Section 1361(b)(3) of the Internal Revenue Code, relating to treatment of certain wholly owned subsidiaries, is modified as follows:

(1) For purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part:

(A) Section 1361(b)(3)(A)(i) of the Internal Revenue Code shall apply, except as provided in subparagraph (B).

(B) There is hereby imposed a tax annually in an amount equal to the applicable amount specified in paragraph (1) of subdivision (d) of Section 23153 on a qualified Subchapter S subsidiary that is incorporated under the laws of this state, qualified to transact intrastate business in this state pursuant to Chapter 21 (commencing with Section 2100) of Division 1 of Title 1 of the Corporations Code, or doing business in this state.

(C) Every qualified Subchapter S subsidiary described in subparagraph (B) shall be subject to the tax imposed under subparagraph (B) from the earlier of the date of incorporation, qualification, or commencement of business in this state, until the effective date of dissolution or withdrawal as provided in Section 23331, or, if later, the date the corporation ceases to do business in this state.

(2) For purposes of Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), and this part:

(A) Section 1361(b)(3)(A)(ii) of the Internal Revenue Code shall not apply and, in lieu thereof, subparagraph (B) shall apply and all references to Section 1361(b)(3)(A)(ii) of the Internal Revenue Code shall be treated as a reference to subparagraph (B).

(B) All activities, assets, liabilities, including liability for the tax imposed under this subdivision, and items of income, deduction, and credit of a qualified Subchapter S subsidiary shall be treated as activities (including activities for purposes of Section 23101), assets, liabilities, and those items, as the case may be, of the ''S corporation.''

(3) Section 1361(b)(3)(B) of the Internal Revenue Code is modified to include the following requirements in addition to the requirements contained therein:

(A) The ''S corporation'' has in effect a valid election to treat the corporation as a qualified Subchapter S subsidiary for federal purposes.

(B) An election made by the ''S corporation'' under Section 1361(b)(3)(B)(ii) of the Internal Revenue Code to treat the corporation as a qualified Subchapter S subsidiary for federal purposes shall be treated for purposes of this part as an election made by the ''S corporation'' under this subdivision and a separate election under paragraph (3) of subdivision (e) of Section 23051.5 shall not be allowed.

(C) No election under this subdivision shall be allowed unless the ''S corporation'' has made the election under Section 1361(b)(3)(B)(ii) of the Internal Revenue Code to treat the corporation as a qualified Subchapter S subsidiary for federal purposes.

(c) Section 1361(c)(6) of the Internal Revenue Code, relating to certain exempt organizations permitted as shareholders, is modified by substituting a reference to Section 17631 or Section 23701d in lieu of the reference to Section 501(c)(3) of the Internal Revenue Code and by substituting a reference to Section 17631 or Section 23701 in lieu of the reference to Section 501(a) of the Internal Revenue Code.

(d) Section 1361(e)(1)(B)(ii) of the Internal Revenue Code, relating to certain trusts not eligible, is modified by substituting ''under Part 10 (commencing with Section 17001) or this part'' in lieu of ''under this subtitle.''

(e) Section 1361(e)(3) of the Internal Revenue Code, relating to election, is modified to include the following provisions:

(1) An election made by the trustee under Section 1361(e) of the Internal Revenue Code to be an electing small business trust for federal purposes shall be treated for purposes of this part as an election made by the trustee under this subdivision and a separate election under paragraph (3) of subdivision (e) of Section 23051.5 shall not be allowed. Any election made shall apply to the taxable year of the trust for which made and to all subsequent taxable years of the trust, unless revoked with the consent of the Franchise Tax Board.

(2) No election under this subdivision shall be allowed unless the trustee has made the election under Section 1361(e) of the Internal Revenue Code to be an electing small business trust for federal purposes.

SEC. 75. Section 23801 of the Revenue and Taxation Code is amended to read:

23801. (a) (1) A corporation may not elect to be treated as an ''S corporation'' unless it has in effect for federal purposes a valid election under Section 1362(a) of the Internal Revenue Code for the same year.

(2) For income years beginning in 1987, the following shall apply:

(A) A corporation that has in effect a valid federal election for the income year beginning in 1987, shall be deemed to have elected to be treated as an ''S corporation'' for purposes of this part, unless that corporation elects on its return to continue to be treated as a ''C corporation'' for purposes of this part.

(B) A corporation to which subparagraph (A) applies, but is not required to file a return under this part, may elect to be treated as a ''C corporation'' for purposes of this part in the form and in the manner as the Franchise Tax Board may prescribe.

(C) A corporation that is deemed to have elected to be treated as an ''S corporation'' under subparagraph (A) shall, for purposes of applying the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, and Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income, be deemed to have made the election to be treated as an ''S corporation'' on the same date as the date of its federal election under Section 1362(a) of the Internal Revenue Code.

(3) For income years beginning in 1988 or 1989, the following shall apply:

(A) A corporation that had in effect a valid federal election for the preceding year, but was a ''C corporation'' for purposes of this part for that preceding year, may elect to be treated as an ''S corporation'' for purposes of this part by making an election in accordance with the provisions of Section 1362 of the Internal Revenue Code in the form and in the manner as the Franchise Tax Board may prescribe.

(B) A corporation that did not have in effect a valid federal election for the preceding year and that makes a federal election for the income year under Section 1362(a) of the Internal Revenue Code shall be deemed to have made an election to be treated as an ''S corporation'' for purposes of this part on the same date as the date of its federal election, unless that corporation elects on its return to continue to be treated as a ''C corporation'' for purposes of this part.

(C) A corporation to which subparagraph (B) applies, but is not required to file a return under this part, may elect to be treated as a ''C corporation'' for purposes of this part in a form and manner as the Franchise Tax Board may prescribe.

(D) A corporation that elects to be treated as an ‘‘S corporation’’ under subparagraph (A) for an income year beginning in 1988 shall, for purposes of applying the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, and Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income, be deemed to have made the election to be treated as an ‘‘S corporation’’ on the same date as the date of its federal election under Section 1362(a) of the Internal Revenue Code.

(4) For income years beginning on or after January 1, 1990, the following shall apply:

(A) An election under Section 1362(a) of the Internal Revenue Code, that is first effective for an income year beginning on or after January 1, 1990, shall be an election to which subdivision (e) of Section 23051.5 applies and shall be deemed to have been made for purposes of this part on the same date as the date of the federal election, unless the corporation files a California election under clause (ii) to be treated as a ‘‘C corporation’’ for purposes of this part.

(i) The federal ‘‘S’’ election shall be reported for purposes of this part in the form and manner as prescribed by the Franchise Tax Board no later than the last date allowed for filing the federal election under Section 1362(a) of the Internal Revenue Code for that income year.

(ii) The California election to be a ‘‘C corporation’’ may only be made by a corporation incorporated in California or qualified to do business in California and shall be made in the form and manner prescribed by the Franchise Tax Board no later than the last date allowed for filing the federal ‘‘S’’ election under Section 1362(a) of the Internal Revenue Code for that income year.

(B) A corporation that has in effect a valid election under Section 1362(a) of the Internal Revenue Code, but is a ‘‘C corporation’’ for purposes of this part, may elect to be treated as an ‘‘S corporation’’ by making an election in the form and manner as prescribed by the Franchise Tax Board at the time required for making an ‘‘S’’ election under Section 1362(a) of the Internal Revenue Code for that income year, unless prohibited from doing so by Section 1362(g) of the Internal Revenue Code, relating to election after termination.

(C) In the event a corporation which has in effect a valid election under Section 1362(a) of the Internal Revenue Code and is not doing business in California becomes subject to this part by qualifying to do business in California, the corporation is deemed to have made an election to be treated as an ‘‘S corporation’’ for the income year during which the corporation qualifies to do business in California, unless the corporation files a California election in accordance with clause (ii) to be treated as a ‘‘C corporation’’ for that income year.

(i) The federal ‘‘S’’ election shall be reported for purposes of this part within two and one-half months after qualifying to do business

in California in the form and manner as prescribed by the Franchise Tax Board.

(ii) The California election to be a ''C corporation'' shall be made in the form and manner as prescribed by the Franchise Tax Board no later than the following:

(I) For an income year beginning in 1990, two and one-half months after qualifying to do business in California.

(II) For an income year beginning on or after January 1, 1991, the last date allowed for filing a federal ''S'' election under Section 1362(a) of the Internal Revenue Code for that income year.

(D) (i) A corporation that is not qualified to do business in California, but is treated as an ''S corporation'' for federal purposes, shall be treated as an ''S corporation'' for purposes of this part, and its shareholders shall be treated as shareholders of an ''S corporation.''

(ii) If a corporation described in clause (i) elected to be treated as a ''C corporation'' under this section prior to its amendment by the act adding this paragraph during the 1989–90 Regular Session, that election shall be revoked for income years beginning on or after January 1, 1990. The corporation shall be treated as an ''S corporation'' for purposes of this part, and its shareholders shall be treated as shareholders of an ''S corporation.''

(E) For purposes of this section, ''qualified to do business in California'' or ''qualifying to do business in California'' means incorporating or obtaining a certificate of qualification pursuant to the Corporations Code.

(F) For purposes of this section:

(i) A timely election to be treated as a ''C corporation'' shall be treated as a revocation and Section 1362(g) of the Internal Revenue Code, relating to election after termination, shall apply.

(ii) An untimely election to be treated as a ''C corporation'' shall be null and void and shall not be applied to either the current or any subsequent income year.

(5) For income years beginning on or after January 1, 1997, the provisions of paragraph (4) shall apply, subject to the following modifications:

(A) A corporation that elects ''S corporation'' status under Section 1362 of the Internal Revenue Code for federal purposes but which is not qualified to be an ''S corporation'' under subdivision (a) of Section 23800.5, shall not be an ''S corporation'' for purposes of Part 10 (commencing with Section 17001) and this part.

(B) (i) A corporation that becomes an ''S corporation'' for an income year beginning before January 1, 1997, under the provisions of Section 1305 of the Small Business Job Protection Act of 1996 (P.L. 104-188) for federal purposes, shall become an ''S corporation'' for purposes of Part 10 (commencing with Section 17001) and this part, for its first income year beginning on or after January 1, 1997, unless a timely election to continue as a ''C corporation'' is made.

(ii) For purposes of clause (i), an election shall be considered timely if made no later than the earlier of the date that is 180 days after the date of enactment of the act adding this paragraph or the due date, without regard to extensions, of the return for its first income year beginning on or after January 1, 1997.

(C) (i) A corporation that makes a valid federal election to be an ''S corporation'' during the period in 1997 before the date of enactment of the act adding this paragraph and which would not qualify to be an ''S corporation'' under this part on the date of the federal election shall become an ''S corporation'' for purposes of Part 10 (commencing with Section 17001) and this part, for its first income year beginning on or after January 1, 1997, unless a timely election to continue as a ''C corporation'' is made.

(ii) For purposes of clause (i), an election shall be considered timely if made no later than the earlier of the date that is 180 days after the date of enactment of the act adding this paragraph or the due date, without regard to extensions, of the return for its first income year beginning on or after January 1, 1997.

(b) If a corporation subject to tax under this part elects to be treated as an ''S corporation'' and has one or more shareholders who are nonresidents of this state or is a trust with a nonresident fiduciary, each of the following shall be required:

(1) Each nonresident shareholder or fiduciary shall file with the return a statement of consent by that shareholder or fiduciary to be subject to the jurisdiction of the State of California to tax the shareholder's pro rata share of the income attributable to California sources.

(2) An ''S corporation'' shall include in its return for each income year a list of shareholders in the form and in the manner prescribed by the Franchise Tax Board.

(3) Failure to meet the requirements of this subdivision shall be grounds for retroactive revocation by the Franchise Tax Board of the election pursuant to this chapter.

(c) Except as provided in subdivision (d), a corporation that makes a valid election to be treated as an ''S corporation'' for purposes of this part shall not be included in a combined report pursuant to Chapter 17 (commencing with Section 25101).

(d) (1) In cases where the Franchise Tax Board determines that the reported income or loss of a group of commonly owned or controlled corporations (within the meaning of Section 25105), which includes one or more corporations electing to be treated as an ''S corporation'' under Chapter 4.5 (commencing with Section 23800), does not clearly reflect income (or loss) of a member of that group or represents an evasion of tax by one or more members of that group, and the Franchise Tax Board determines that the comparable uncontrolled price method prescribed by regulations pursuant to Section 482 of the Internal Revenue Code cannot practically be

applied, the Franchise Tax Board may, in lieu of other methods prescribed by regulations pursuant to Section 482 of the Internal Revenue Code, apply methods of unitary combination, pursuant to Article 1 (commencing with Section 25101) of Chapter 17, to properly reflect the income or loss of the members of the group.

(2) The application of the provisions of this subdivision shall not affect the election of any corporation to be treated as an ''S corporation.''

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

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

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

(3) A corporation which is qualified to do business in California and has in effect a valid ''S'' election under Section 1362(a) of the Internal Revenue Code, may revoke its ''S'' election for purposes of this part without revoking its federal election. The revocation for purposes of this part shall be made by providing a written notification to the Franchise Tax Board in the form and manner prescribed by the Franchise Tax Board which includes the California corporation number and meets the requirements of Section 1362(d)(1) of the Internal Revenue Code.

(g) For income years beginning on or after January 1, 1990, if a corporation, which has in effect a valid ''S'' election under Section 1362(a) of the Internal Revenue Code, fails to make a ''C corporation'' election under clause (ii) of subparagraphs (A) and (C) of paragraph (4) of subdivision (a) or to terminate by revocation under paragraph (3) of subdivision (f), the corporation shall be treated as an ''S corporation'' pursuant to subparagraph (A) of paragraph (4) of subdivision (a).

(h) For income years beginning on or after January 1, 1997, for purposes of subparagraph (F) of paragraph (4) of subdivision (a) of this section and Section 1362(g) of the Internal Revenue Code, relating to election after termination, any termination under Section 1362(d) of the Internal Revenue Code or election to be treated as a ''C corporation'' under subparagraph (A) or (C) of paragraph (4) of subdivision (a), or to terminate by revocation under paragraph (3)

of subdivision (f) in an income year beginning before January 1, 1997, shall not be taken into account.

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

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

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

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

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

SEC. 76. Section 23806 of the Revenue and Taxation Code is repealed.

SEC. 77. Section 23806 is added to the Revenue and Taxation Code, to read:

23806. (a) Section 1371(a) of the Internal Revenue Code, relating to application of Subchapter C rules, is modified to provide that, notwithstanding subdivisions (a) and (e) of Sections 17024.5 and 23051.5, any election by an ''S corporation'' or its shareholders under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, for federal purposes shall be treated as an election for purposes of this part and a separate election

under paragraph (3) of subdivision (e) of Section 17024.5 or 23051.5 shall not be allowed.

(b) No election under Section 338 of the Internal Revenue Code, relating to certain stock purchases treated as asset acquisitions, shall be allowed for state purposes unless the ''S corporation'' or its shareholders made a valid election for federal purposes under Section 338 of the Internal Revenue Code.

(c) Section 1371 (d) of the Internal Revenue Code shall not apply.

(d) (1) Subdivisions (a) and (b) shall apply to any transaction occurring on or after January 1, 1998, in an income year beginning on or after January 1, 1997.

(2) Subdivision (c) shall apply to income years beginning on or after January 1, 1997.

SEC. 78. Section 24309.5 is added to the Revenue and Taxation Code, to read:

24309.5. Section 110 of the Internal Revenue Code, relating to qualified lessee construction allowances for short-term leases, shall apply, except as otherwise provided.

(a) Section 110(b) of the Internal Revenue Code is modified by substituting the phrase ''(including for purposes of paragraph (2) of subdivision (e) of Section 24349)'' for the phrase ''(including for purposes of Section 168(i)(8)(B).''

(b) Section 110(c)(2) of the Internal Revenue Code is modified by substituting the phrase ''(as determined under the rules of paragraph (3) of subdivision (e) of Section 24349)'' for the phrase ''(as determined under the rules of Section 168(i)(3)).''

SEC. 79. 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 income 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 income 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 an income 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 an income 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).''

SEC. 80. Section 24355.4 is added to the Revenue and Taxation Code, to read:

24355.4. For purposes of computing the depreciation deduction under Section 24349, a class life of four years shall be used for any qualified rent-to-own property as defined in Section 168(i)(14) of the Internal Revenue Code.

SEC. 81. Section 24357.7 of the Revenue and Taxation Code is amended to read:

24357.7. (a) (1) For purposes of paragraph (3) of subdivision (b) of Section 24357.2, the term ''qualified conservation contribution'' means a contribution—

(A) Of a qualified real property interest,

(B) To a qualified organization,

(C) Exclusively for conservation purposes.

(2) For purposes of this subdivision, the term ''qualified real property interest'' means any of the following interests in real property:

(i) The entire interest of the donor other than a qualified mineral interest.

(ii) A remainder interest.

(iii) A restriction (granted in perpetuity) on the use which may be made of the real property.

(b) For purposes of subdivision (a), the term ''qualified organization'' means an organization which:

(1) Is described in subdivision (a) or (b) of Section 24359, or

(2) Is described in Section 23701(d), and—

(A) Meets the requirements of Section 509(a)(2) of the Internal Revenue Code, or

(B) Meets the requirements of Section 509(a)(3) of the Internal Revenue Code and is controlled by an organization described in paragraph (1) or in subparagraph (A).

(c) For purposes of this section, the term ''conservation purpose'' means any of the following:

(1) The preservation of land areas for outdoor recreation by, or the education of, the general public.

(2) The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem.

(3) The preservation of open space (including farm land and forest land) where that preservation is for any of the following:

(A) For the scenic enjoyment of the general public.

(B) Pursuant to a clearly delineated federal, state, or local governmental conservation policy, and will yield a significant public benefit.

(C) The preservation of a historically important land area or a certified historic structure.

(d) The term ''certified historic structure'' means any building, structure, or land area which:

(1) Is listed in the National Register, or

(2) Is located in a registered historic district (as defined in Section 47(c)(3)(B)) of the Internal Revenue Code and is certified by the Secretary of the Interior to the secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies that sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this part for the income year in which the transfer is made.

(e) For purposes of this section:

(1) A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

(2) (A) Except as provided in subparagraph (B), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, this subdivision shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

(B) With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, paragraph (1) shall be treated as met if the probability of surface mining occurring on that property is so remote as to be negligible.

(f) For purposes of this section, the term ‘‘qualified mineral interest’’ means—

(1) Subsurface oil, gas, or other minerals; and

(2) The right to access to those minerals.

SEC. 82. Section 24357.8 of the Revenue and Taxation Code is amended to read:

24357.8. (a) In the case of a qualified research contribution, the amount otherwise allowed as a deduction under Section 24357, shall be reduced by that amount of the reduction provided by Section 24357.1 which is no greater than the sum of the following:

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

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

(b) For purposes of this section, ‘‘qualified research contribution’’ means a charitable contribution by a taxpayer of tangible personal property described in paragraph (1) of Section 1221 of the Internal Revenue Code, but only if all of the following conditions are met:

(1) The contribution is to an educational organization which is described in subsection (b)(1)(A)(ii) of Section 170 of the Internal Revenue Code and which is an institution of higher education (as defined in Section 3304(f) of the Internal Revenue Code of 1954) in California.

(2) The contribution is made not later than two years after the date the construction of the property is substantially completed.

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

(4) The property is scientific equipment or apparatus substantially all of the use of which by the donee is for research or experimentation (within the meaning of Section 24365), or for research training, in physical, applied, or biological sciences, or for instructional purposes.

(5) The property is not transferred by the donee in exchange for money, other property, or services.

(6) The taxpayer receives from the donee a written statement representing that its use and disposition of the property will be in accordance with this section, and with respect to property substantially all of the use of which is for instructional purposes, the taxpayer receives from the donee a written statement representing that the property will be used as an integral part of the instructional program. In the case of a computer, the statement shall also represent that the donee has acquired or will acquire, necessary basic operational software and the means to provide trained staff to utilize the property.

(7) The contribution is made on or after July 1, 1983, and on or before December 31, 1993.

(8) The taxpayer shall report to the Franchise Tax Board, on forms prescribed by the board, the name and address of the recipient educational organization, a description of the qualified charitable contribution, the fair market value of the contribution, and the date the contribution was made. The taxpayer shall forward a copy of the forms, along with the written statements prescribed in paragraph (6), to the following:

(A) The President of the University of California, in the case of contributions to institutions within the University of California system.

(B) California Postsecondary Education Commission, in the case of contributions to private institutions.

(C) The Chancellor of the California State University, in the case of contributions to institutions within the California State University system.

(D) The Chancellor of the California Community Colleges, in the case of contributions to institutions within the California Community College system.

(c) For purposes of this section, the term ''taxpayer'' shall not include a service organization (as defined in Section 414(m)(3) of the Internal Revenue Code).

SEC. 83. Section 24357.9 is added to the Revenue and Taxation Code, to read:

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

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

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

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

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

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

(B) An entity described in Section 23701d and exempt from tax under Section 23701 (other than an entity described in subparagraph

(A)) that is organized primarily for purposes of supporting elementary and secondary education in California.

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

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

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

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

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

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

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

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

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

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

(B) Notifies the donor of that contribution.

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

(e) For purposes of this section:

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

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

(A) An ''S corporation.''

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

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

(f) This section shall not apply to any contribution made during any income year beginning on or after January 1, 2000.

SEC. 84. Section 24369.4 is added to the Revenue and Taxation Code, 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) (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.

SEC. 85. Section 24402 of the Revenue and Taxation Code is amended to read:

24402. (a) A portion of the dividends received during the income year declared from income which has been included in the measure of the taxes imposed under Chapter 2 (commencing with Section 23101), Chapter 2.5 (commencing with Section 23400), or Chapter 3 (commencing with Section 23501) upon the taxpayer declaring the dividends.

(b) The portion of dividends which may be deducted under this section shall be as follows:

(1) In the case of any dividend described in subdivision (a), received from a ‘‘more than 50 percent owned corporation,’’ 100 percent.

(2) In the case of any dividend described in subdivision (a), received from a ''20 percent owned corporation,'' 80 percent.

(3) In the case of any dividend described in subdivision (a), received from a corporation that is less than 20 percent owned, 70 percent.

(c) For purposes of this section:

(1) The term ''more than 50 percent owned corporation'' means any corporation if more than 50 percent of the stock of that corporation (by vote and value) is owned by the taxpayer. For purposes of the preceding sentence, stock described in Section 1504(a)(4) of the Internal Revenue Code shall not be taken into account.

(2) The term ''20 percent owned corporation'' means any corporation if 20 percent or more of the stock of that corporation (by vote and value) is owned by the taxpayer. For purposes of the preceding sentence, stock described in Section 1504(a)(4) of the Internal Revenue Code shall not be taken into account.

(d) (1) No deduction shall be allowed under this section in respect of any dividend on any share of stock:

(A) which is held by the taxpayer for 45 days or less during the 90-day period beginning on the date which is 45 days before the date on which the share becomes ex-dividend with respect to that dividend, or

(B) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

(2) In the case of stock having preference in dividends, if the taxpayer receives dividends with respect to that stock which are attributable to a period or periods aggregating in excess of 366 days, subparagraph (A) of paragraph (1) shall be applied as follows:

(A) By substituting ''90 days'' for ''45 days'' in each place it appears.

(B) By substituting ''180-day period'' for ''90-day period.''

(3) For purposes of this subdivision, in determining the period for which the taxpayer has held any share of stock:

(A) the day of disposition, but not the day of acquisition, shall be taken into account, and

(B) Section 1223(4) of the Internal Revenue Code shall not apply.

(4) Section 246(c)(4) of the Internal Revenue Code, relating to the holding period reduced for periods where risk of loss diminished, shall apply, except as otherwise provided.

(e) (1) The amendments made by the act adding this subdivision shall apply to dividends received or accrued after the 30th day after the date of the enactment of the act adding this subdivision.

(2) The amendments made by the act adding this subdivision shall not apply to dividends received or accrued during the two-year

period beginning on the date of the enactment of the act adding this subdivision if:

(A) the dividend is paid with respect to stock held by the taxpayer on January 1, 1998 and all times thereafter until the dividend is received,

(B) that stock is continuously subject to a position described in Section 246(c)(4) of the Internal Revenue Code on January 1, 1998, and all times thereafter until the dividend is received, and

(C) that stock and position are clearly identified in the taxpayer's records within 30 days after the date of the enactment of the act adding this subdivision.

(3) Stock shall not be treated as meeting the requirement of subparagraph (B) of paragraph (2) if the position is sold, closed, or otherwise terminated and reestablished.

SEC. 86. Section 24416 of the Revenue and Taxation Code is amended to read:

24416. Except as provided in Sections 24416.1 and 24416.2, a net operating loss deduction shall be allowed in computing net income under Section 24341 and shall be determined in accordance with Section 172 of the Internal Revenue Code, except as otherwise provided.

(a) (1) Net operating losses attributable to income years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any income year beginning before January 1, 1987.

(b) (1) Except as provided in paragraphs (2) and (3), the provisions of Section 172(b)(2) of the Internal Revenue Code, relating to the amount of carryovers, shall be modified so that 50 percent of the entire amount of the net operating loss for any income year shall not be eligible for carryover to any subsequent income year.

(2) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates a new business during that income year, each of the following shall apply to each loss incurred during the first three income years of operating the new business:

(A) If the net operating loss is equal to or less than the net loss from the new business, 100 percent of the net operating loss shall be carried forward as provided in paragraph (2) of subdivision (e).

(B) If the net operating loss is greater than the net loss from the new business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the new business, 100 percent of that amount shall be carried forward as provided in paragraph (2) of subdivision (e).

(ii) With respect to the portion of the net operating loss that exceeds the net loss from the new business, 50 percent of that amount

shall be a net operating loss carryover to each of the five taxable years following the taxable year of the loss.

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(3) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates an eligible small business during that income year, each of the following shall apply:

(A) If the net operating loss is equal to or less than the net loss from the eligible small business, 100 percent of the net operating loss shall be carried forward to the income years specified in paragraph (1) of subdivision (e).

(B) If the net operating loss is greater than the net loss from the eligible small business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the eligible small business, 100 percent of that amount shall be carried forward to each of the five income years following the income year of the loss.

(ii) With respect to the portion of the net operating loss that exceeds the net loss from the eligible small business, 50 percent of that amount shall be a net operating loss carryover to each of the five income years following the income year of the loss.

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(4) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates a business that qualifies as both a new business and an eligible small business under this section, that business shall be treated as a new business for the first three income years of the new business.

(5) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates more than one business, and more than one of those businesses qualifies as either a new business or an eligible small business under this section, paragraph (2) shall be applied first, except that if there is any remaining portion of the net operating loss after application of clause (i) of subparagraph (B) of paragraph (2), paragraph (3) shall be applied to the remaining portion of the net operating loss as though that remaining portion of the net operating loss constituted the entire net operating loss.

(6) For purposes of this section, ‘‘net loss’’ means the amount of net loss after application of Sections 465 and 469 of the Internal Revenue Code.

(c) For any income year in which the taxpayer has in effect a water's-edge election under Section 25110, the deduction of a net operating loss carryover shall be denied to the extent that the net operating loss carryover was determined by taking into account the income and factors of an affiliated corporation in a combined report whose income and apportionment factors would not have been taken into account if a water's-edge election under Section 25110 had been in effect for the income year in which the loss was incurred.

(d) Net operating loss carrybacks shall not be allowed.

(e) (1) Except as provided in paragraphs (2), (3), and (4), for each income year beginning on or after January 1, 1987, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute ''five income years'' in lieu of ''20 taxable years.''

(2) In the case of a ''new business,'' the ''five income years'' referred to in paragraph (1) shall be modified to read as follows:

(A) ''Eight income years'' for a net operating loss attributable to the first income year of that new business.

(B) ''Seven income years'' for a net operating loss attributable to the second income year of that new business.

(C) ''Six income years'' for a net operating loss attributable to the third income year of that new business.

(3) For any carryover of a net operating loss for which a deduction is denied by Section 24416.3, the carryover period specified in this subdivision shall be extended as follows:

(A) By one year for a net operating loss attributable to income years beginning in 1991.

(B) By two years for a net operating loss attributable to income years beginning prior to January 1, 1991.

(4) The net operating loss attributable to income years beginning on or after January 1, 1987, and before January 1, 1994, shall be a net operating loss carryover to each of the 10 income years following the year of the loss if it is incurred by a corporation that was either of the following:

(A) Under the jurisdiction of the court in a Title 11 or similar case at any time prior to January 1, 1994. The loss carryover provided in the preceding sentence shall not apply to any loss incurred in an income year after the income year during which the corporation is no longer under the jurisdiction of the court in a Title 11 or similar case.

(B) In receipt of assets acquired in a transaction that qualifies as a tax-free reorganization under Section 368(a)(1)(G) of the Internal Revenue Code.

(f) For purposes of this section:

(1) ''Eligible small business'' means any trade or business that has gross receipts, less returns and allowances, of less than one million dollars ($1,000,000) during the income year.

(2) Except as provided in subdivision (g), ‘‘new business’’ means any trade or business activity that is first commenced in this state on or after January 1, 1994.

(3) ‘‘Title 11 or similar case’’ shall have the same meaning as in Section 368(a)(3) of the Internal Revenue Code.

(4) In the case of any trade or business activity conducted by a partnership or an S corporation, paragraphs (1) and (2) shall be applied to the partnership or S corporation.

(g) For purposes of this section, in determining whether a trade or business activity qualifies as a new business under paragraph (2) of subdivision (e), the following rules shall apply:

(1) In any case where a taxpayer purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by the taxpayer (or any related person) shall not be treated as a new business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by the taxpayer (or any related person) in the conduct of its trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the taxpayer (or any related person). For purposes of this paragraph only, the following rules shall apply:

(A) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the first income year in which the taxpayer (or any related person) first uses any of the acquired trade or business assets in its business activity.

(B) Any acquired assets that constituted property described in Section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(1) of the Internal Revenue Code in the hands of the acquiring taxpayer (or related person).

(2) In any case where a taxpayer (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (‘‘prior trade or business activity’’), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the taxpayer’s (or any related person’s) current or prior trade or business activities.

(3) In any case where a taxpayer, including all related persons, is engaged in trade or business activities wholly outside of this state and

the taxpayer first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in paragraph (1)), the trade or business activity shall be treated as a new business under paragraph (2) of subdivision (e).

(4) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the taxpayer as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of paragraph (1) of this subdivision.

(5) ''Related person'' shall mean any person that is related to the taxpayer under either Section 267 or 318 of the Internal Revenue Code.

(6) ''Acquire'' shall include any transfer, whether or not for consideration.

(7) (A) For income years beginning on or after January 1, 1997, the term ''new business'' shall include any taxpayer that is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and as further amended, and that has not received regulatory approval for any product from the United States Food and Drug Administration.

(B) For purposes of this paragraph:

(i) ''Biopharmaceutical activities'' means those activities which use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

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

(h) For purposes of corporations whose net income is determined under Chapter 17 (commencing with Section 25101), Section 25108 shall apply to each of the following:

(1) The amount of net operating loss incurred in any income year which may be carried forward to another income year.

(2) The amount of any loss carry forward which may be deducted in any income year.

(i) The provisions of Section 172(b)(1)(D) of the Internal Revenue Code, relating to bad debt losses of commercial banks, shall not be applicable.

(j) The Franchise Tax Board may prescribe appropriate regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, tiered ownership structures, or otherwise.

(k) The Franchise Tax Board may reclassify any net operating loss carryover determined under either paragraph (2) or (3) of subdivision (b) as a net operating loss carryover under paragraph (1) of subdivision (b) upon a showing that the reclassification is necessary to prevent evasion of the purposes of this section.

(*l*) The amendments made by the act adding this subdivision shall be operative for income years beginning on or after January 1, 1997.

SEC. 87. Section 24424 of the Revenue and Taxation Code is amended to read:

24424. (a) No deduction shall be allowed for—

(1) Premiums paid on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under that policy or contract.

(2) Any amount paid or accrued on indebtedness incurred to purchase or carry a single premium life insurance, endowment, or annuity contract. This paragraph shall apply with respect to annuity contracts only as to contracts purchased after December 31, 1954.

(3) Except as provided in subdivision (c), any amount paid or accrued on indebtedness incurred or continued to purchase or carry a life insurance, endowment, or annuity contract (other than a single premium contract or a contract treated as a single premium contract) pursuant to a plan of purchase which contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of that contract (either from the insurer or otherwise). This paragraph shall apply only with respect to contracts purchased after August 6, 1963.

(4) Except as provided in subdivision (d), any interest paid or accrued on any indebtedness with respect to one or more insurance policies owned by the taxpayer covering the life of any individual, or any endowment or annuity contracts owned by the taxpayer covering any individual.

This paragraph shall apply with respect to contracts purchased after June 20, 1986.

(b) Paragraph (1) of subdivision (a) shall not apply to either of the following:

(1) Any annuity contract described in Section 72(s)(5) of the Internal Revenue Code.

(2) Any annuity contract to which Section 72(u) of the Internal Revenue Code applies.

(c) For purposes of paragraph (2) of subdivision (a), a contract shall be treated as a single premium contract if either of the following conditions exist:

(1) Substantially all the premiums on the contract are paid within a period of four years from the date on which the contract is purchased.

(2) An amount is deposited after December 31, 1954, with the insurer for payment of a substantial number of future premiums on the contract.

(d) Paragraph (3) of subdivision (a) shall not apply to any amount paid or accrued by a person during an income year on indebtedness incurred or continued as part of a plan referred to in paragraph (3) of subdivision (a) if any of the following is applicable:

(1) No part of four of the annual premiums due during the seven-year period (beginning with the date the first premium on the contract to which that plan relates was paid) is paid under that plan by means of indebtedness.

(2) The total of the amounts paid or accrued by that person during that income year for which (without regard to this paragraph) no deduction would be allowable by reason of paragraph (3) of subdivision (a) does not exceed one hundred dollars ($100).

(3) That amount was paid or accrued on indebtedness incurred because of an unforeseen substantial loss of income or unforeseen substantial increase in its financial obligations.

(4) That indebtedness was incurred in connection with its trade or business.

For purposes of applying paragraph (1), if there is a substantial increase in the premiums on a contract, a new seven-year period described in that paragraph with respect to that contract shall commence on the date the first increased premium is paid.

(e) (1) Paragraph (4) of subdivision (a) shall not apply to any interest paid or accrued on any indebtedness with respect to policies or contracts covering an individual who is a key person to the extent that the aggregate amount of that indebtedness with respect to policies and contracts covering that individual does not exceed fifty thousand dollars ($50,000).

(2) (A) No deduction shall be allowed by reason of paragraph (1) or the last sentence of subdivision (a) with respect to interest paid or accrued for any month beginning after December 31, 1995, to the extent the amount of that interest exceeds the amount which would have been determined if the applicable rate of interest were used for that month.

(B) For purposes of subparagraph (A):

(i) The applicable rate of interest for any month is the rate of interest described as Moody's Corporate Bond Yield Average-Monthly Average Corporates, as published by Moody's Investors Service, Inc., or any successor thereto, for that month.

(ii) In the case of indebtedness on a contract purchased on or before June 20, 1986, all of the following shall apply:

(I) If the contract provides a fixed rate of interest, the applicable rate of interest for any month shall be the Moody's rate described in clause (i) for the month in which the contract was purchased.

(II) If the contract provides a variable rate of interest, the applicable rate of interest for any month in an applicable period shall be the Moody's rate described in clause (i) for the third month preceding the first month in that period.

(III) For purposes of subclause (II), the term ''applicable period'' means the 12-month period beginning on the date the policy is issued (and each successive 12-month period thereafter) unless the taxpayer elects a number of months (not greater than 12) other than that 12-month period to be its applicable period. That election shall be made not later than the 90th day after the date of the enactment of the act adding this sentence and, if made, shall apply to the taxpayer's first income year ending on or after December 31, 1995, and all subsequent income years, unless revoked with the consent of the Franchise Tax Board.

(3) For purposes of paragraph (1), ''key person'' means an officer or 20-percent owner, except that the number of individuals who may be treated as key persons with respect to any taxpayer shall not exceed the greater of:

(A) Five individuals.

(B) The lesser of 5 percent of the total officers and employees of the taxpayer or 20 individuals.

(4) For purposes of this subdivision, ''20-percent owner'' means both of the following:

(A) If the taxpayer is a corporation, any person who directly owns 20 percent or more of the outstanding stock of the corporation or stock possessing 20 percent or more of the total combined voting power of all stock of the corporation.

(B) If the taxpayer is not a corporation, any person who owns 20 percent or more of the capital or profits interest in the taxpayer.

(5) (A) For purposes of subparagraph (A) of paragraph (4) and for purposes of applying the fifty thousand dollars ($50,000) limitation in paragraph (1) both of the following shall apply:

(i) All members of a controlled group shall be treated as one taxpayer.

(ii) The limitation shall be allocated among the members of the controlled group in the manner the Franchise Tax Board may prescribe.

(B) For purposes of this paragraph, all persons treated as a single employer under Section 52(a) or 52(b) of the Internal Revenue Code, relating to special rules, or Section 414(m) or 414(o) of the Internal Revenue Code, relating to definitions and special rules, shall be treated as members of a controlled group.

(f)(1) No deduction shall be allowed for that portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values.

(2) For purposes of paragraph (1), the portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values is an amount which bears the same ratio to the interest expense as:

(A) The taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, bears to

(B) The sum of:

(i) In the case of assets of the taxpayer which are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values of those policies and contracts, and

(ii) In the case of assets of the taxpayer not described in clause (i), the average adjusted bases (within the meaning of Section 24916) of those assets.

(3) For purposes of this subdivision, the term ''unborrowed policy cash value'' means, with respect to any life insurance policy or annuity or endowment contract, the excess of:

(A) The cash surrender value of the policy or contract determined without regard to any surrender charge, over

(B) The amount of any loan with respect to that policy or contract.

(4) (A) Paragraph (1) shall not apply to any policy or contract owned by an entity engaged in a trade or business if the policy or contract covers only one individual and if that individual is (at the time first covered by the policy or contract):

(i) A 20-percent owner of the entity, or

(ii) An individual (not described in clause (i)) who is an officer, director, or employee of that trade or business.

A policy or contract covering a 20-percent owner of the entity shall not be treated as failing to meet the requirements of the preceding sentence by reason of covering the joint lives of the owner and the owner's spouse.

(B) Paragraph (1) shall not apply to any annuity contract to which Section 72(u) of the Internal Revenue Code applies.

(C) Any policy or contract to which paragraph (1) does not apply by reason of this paragraph shall not be taken into account under paragraph (2).

(D) For purposes of subparagraph (A), the term ''20-percent owner'' has the meaning given such term by paragraph (4) of subdivision (e).

(5)(A)(i) This subdivision shall not apply to any policy or contract held by a natural person.

(ii) If a trade or business is directly or indirectly the beneficiary under any policy or contract, the policy or contract shall be treated as held by that trade or business and not by a natural person.

(iii)(I) Clause (ii) shall not apply to any trade or business carried on as a sole proprietorship and to any trade or business performing services as an employee.

(II) The amount of the unborrowed cash value of any policy or contract which is taken into account by reason of clause (ii) shall not exceed the benefit to which the trade or business is directly or indirectly entitled under the policy or contract.

(iv) A copy of the report required for federal purposes under Section 264(f) of the Internal Revenue Code shall be filed with the Franchise Tax Board at a time and in the manner specified for federal purposes and shall be treated as a statement referred to in Section 6724(d)(1) of the Internal Revenue Code.

(B) In the case of a partnership or S corporation, this subdivision shall be applied at the partnership and corporate levels.

(6)(A) If interest on any indebtedness is disallowed under subdivision (a) or Section 24425, both of the following shall apply:

(i) The disallowed interest shall not be taken into account for purposes of applying this subdivision.

(ii) The amount otherwise taken into account under subparagraph (B) of paragraph (2) shall be reduced (but not below zero) by the amount of the indebtedness.

(B) This subdivision shall be applied before the application of Section 263A of the Internal Revenue Code, relating to capitalization of certain expenses where taxpayer produces property.

(7) The term ''interest expense'' means the aggregate amount allowable to the taxpayer as a deduction for interest (within the meaning of Section 24344) for the income year (determined without regard to this subdivision, Section 24425, and Section 291 of the Internal Revenue Code).

(8) All members of a controlled group (within the meaning of subparagraph (B) of paragraph (5) of subdivision (e)) shall be treated as one taxpayer for purposes of this subdivision.

(g) (1) The amendments made to this section by the act adding this subdivision shall apply to interest paid or accrued after December 31, 1995.

(2) (A) The amendments made to this section by the act adding this subdivision shall not apply to qualified interest paid or accrued on that indebtedness after December 31, 1995, and before January 1, 1999, in the case of either of the following:

(i) Indebtedness incurred before January 1, 1996.

(ii) Indebtedness incurred before January 1, 1997, with respect to any contract or policy entered into in 1994 or 1995.

(B) For purposes of subparagraph (A), the qualified interest with respect to any indebtedness for any month is the amount of interest (otherwise deductible) which would be paid or accrued for that month on that indebtedness if—

(i) In the case of any interest paid or accrued after December 31, 1995, indebtedness with respect to no more than 20,000 insured individuals were taken into account, and

(ii) The lesser of the following rates of interest were used for that month:

(I) The rate of interest specified under the terms of the indebtedness as in effect on December 31, 1995 (and without regard to modification of the terms after that date).

(II) The applicable percentage of the rate of interest described as Moody's Corporate Bond Yield Average-Monthly Average Corporates as published by Moody's Investors Service, Inc., or any successor thereto, for that month. For purposes of clause (i), all persons treated as a single employer under Section 52(a) or 52(b) of the Internal Revenue Code, relating to special rules, or Section 414(m) or 414(o) of the Internal Revenue Code, relating to definitions and special rules, shall be treated as one person. Subclause (II) of clause (ii) shall not apply to any month before January 1, 1996.

(C) For purposes of subparagraph (B), the applicable percentage is as follows:

For calendar year:	The percentage is:
1996	100 percent
1997	90 percent
1998	80 percent

(3) This subdivision shall not apply to any contract purchased on or before June 20, 1986, except that paragraph (2) of subdivision (d) shall apply to interest paid or accrued after December 31, 1995.

(h) (1) Any amount received under any life insurance policy or endowment or annuity contract described in paragraph (4) of subdivision (a) shall be includable in gross income (in lieu of any other inclusion in gross income) ratably over the four-income-year period beginning with the income year that amount would (but for this paragraph) be includable, upon the occurrence of either of the following:

(A) The complete surrender, redemption, or maturity of that policy or contract during calendar year 1996, 1997, or 1998.

(B) The full discharge during calendar year 1996, 1997, or 1998 of the obligation under the policy or contract which is in the nature of a refund of the consideration paid for the policy or contract.

(2) Paragraph (1) shall only apply to the extent the amount is includable in gross income for the income year in which the event described in subparagraph (A) or (B) of paragraph (1) occurs.

(3) Solely by reason of an occurrence described in subparagraph (A) or (B) of paragraph (1) or solely by reason of no additional premiums being received under the contract by reason of a lapse

occurring after December 31, 1995, a contract shall not be treated as either of the following:

(A) Failing to meet the requirement of paragraph (1) of subdivision (c).

(B) A single premium contract under paragraph (1) of subdivision (b).

(i) The amendments made by the act adding this subdivision shall apply to contracts issued after June 8, 1997, in income years beginning on or after January 1, 1998. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract, except that the addition of covered lives shall be treated as a new contract only with respect to those additional covered lives. For purposes of this subdivision, an increase in the death benefit under a policy of contract issued in connection with a lapse described in Section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

SEC. 88. Section 24611 of the Revenue and Taxation Code is amended to read:

24611. (a) Section 404(k) of the Internal Revenue Code, relating to dividends paid deduction, shall apply to income years beginning on or after January 1, 1995.

(b) For income years beginning on or after January 1, 1998, Section 404(a)(9) of the Internal Revenue Code, relating to certain contributions to employee ownership plans, is modified to provide that Section 404(a)(9) of the Internal Revenue Code shall not apply to an ''S corporation.''

(c) For income years beginning on or after January l, 1998, Section 404(k)(1) of the Internal Revenue Code, relating to deduction for dividends on certain employer securities, is modified to provide that the phrase ''a corporation'' shall read ''a C corporation.''

SEC. 89. Section 24652.5 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

24652.5. (a) (1) Section 447(i)(3) of the Internal Revenue Code, relating to reduction in account if farming business contracts, shall not apply.

(2) Section 447(i)(4) of the Internal Revenue Code, relating to income inclusions, shall not apply.

(3) (A) No suspense account may be established under Section 447(i) of the Internal Revenue Code, relating to suspense account for family corporations, by any corporation required by Section 447 of the Internal Revenue Code, relating to method of accounting for corporations engaged in farming, to change its method of accounting for any income year ending after June 8, 1997.

(B) (i) Each suspense account under Section 447(i) of the Internal Revenue Code shall be reduced (but not below zero) for

each income year beginning after June 8, 1997, by an amount equal to the lesser of:

(I) The applicable portion of the account.

(II) Fifty percent of the net income of the corporation for the income year, or, if the corporation has no net income for that year, the amount of any net operating loss (as defined in Section 172 of the Internal Revenue Code and as modified for purposes of this part) for that income year.

For purposes of the preceding sentence, the amount of net income and net operating loss shall be determined without regard to this paragraph.

(ii) The amount of the applicable portion for any income year shall be reduced (but not below zero) by the amount of any reduction required for the income year under any other provision of Section 447(i) of the Internal Revenue Code.

(iii) Any reduction in a suspense account under this paragraph shall be included in gross income for the income year of the reduction.

(C) For purposes of subparagraph (B), the term ''applicable portion'' means, for any income year, the amount which would ratably reduce the amount in the account (after taking into account prior reductions) to zero over the period consisting of that income year and the remaining income years in those first 20 income years.

(D) Any amount in the account as of the close of that 20th year referred to in subparagraph (C) shall be treated as the applicable portion for each succeeding year thereafter to the extent not reduced under this paragraph for any prior income year after the 20th year.

(b) This section shall apply to income years ending on or after December 31, 1997.

(c) This section shall not apply to income years beginning on or after January 1, 1998.

SEC. 90. Section 24661.5 of the Revenue and Taxation Code, as added by Section 35 of Chapter 7 of the Statutes of 1998, is amended to read:

24661.5. (a) Section 451(e) of the Internal Revenue Code, relating to special rule for proceeds from livestock sold on account of drought, is modified by substituting the phrase ''drought, flood, or other weather-related conditions, and that those conditions'' in lieu of the phrase ''drought conditions, and that these drought conditions'' contained therein.

(b) This section shall apply to sales and exchanges after December 31, 1996.

(c) This section shall not apply to income years beginning on or after January 1, 1998.

SEC. 91. Section 24673.2 of the Revenue and Taxation Code is amended to read:

24673.2. (a) Section 460 of the Internal Revenue Code, relating to special rules for long-term contracts, shall apply, except as otherwise provided.

(b) (1) Section 804(d) of Public Law 99-514, relating to the effective date of modifications in the method of accounting for long-term contracts, shall apply to income years beginning on or after January 1, 1987.

(2) In the case of a contract entered into after February 28, 1986, during an income year beginning before January 1, 1987, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between state and federal law for the income year in which the contract began.

(c) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 10203 of Public Law 100-203, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to each income year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after October 13, 1987, during an income year beginning before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between state and federal law for each income year beginning prior to January 1, 1990.

(d) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 5041 of Public Law 100-647, relating to a reduction in the percentage of items taken into account under the completed contract method, shall apply to each income year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after June 20, 1988, during an income year beginning before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income, for purposes of this part, resulting from differences between state and federal law for each income year beginning prior to January 1, 1990.

(e) (1) The amendments to Section 460 of the Internal Revenue Code made by Section 7621 of Public Law 101-239, relating to the repeal of the completed contract method of accounting for long-term contracts, shall apply to each income year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after July 10, 1989, during an income year beginning on or before January 1, 1990, an adjustment to income shall be made upon completion of the contract, if necessary, to correct any underreporting or overreporting of income,

for purposes of this part, resulting from differences between state and federal law for each income year beginning prior to January 1, 1990.

(f) For purposes of applying paragraphs (2) to (6), inclusive, of Section 460(b) of the Internal Revenue Code, relating to the look-back method, any adjustment to income computed under paragraph (2) of subdivision (b), (c), (d), or (e) shall be deemed to have been reported in the income year from which the adjustment arose, rather than the income year in which the contract was completed.

SEC. 92. Section 24710 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

(2) Section 1001(d)(4)(B) of the Taxpayer Relief Act of 1997 (P.L. 105-34), relating to the effective date for election of mark to market by securities traders and traders and dealers in commodities, is modified to provide that the requirement for timely identification shall be treated as timely made for state purposes if that identification is treated as timely made for federal purposes, and the amount taken into account under Section 481 of the Internal Revenue Code of 1986

shall be taken into account ratably over the four-income-year period beginning with the first income year beginning on or after January 1, 1998.

SEC. 93. Section 24871.5 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

24871.5. (a) Section 851(b)(3) of the Internal Revenue Code shall not apply.

(b) This section shall apply in determining whether an entity qualifies as a regulated investment company for income years of that entity beginning after August 5, 1997.

(c) This section shall not apply to income years beginning on or after January 1, 1998.

SEC. 94. Section 24872.4 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

24872.4. (a) Section 856(d)(7)(C)(ii) of the Internal Revenue Code is modified by substituting the phrase ''if received by an organization described in subdivision (b) of Section 17651 of Part 10 or Section 23731'' for the phrase ''if received by an organization described in section 511(a)(2).''

(b) (1) An election under Section 856(e)(5) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as an election made by the real estate investment trust under Section 856 (e)(5) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 23051.5 shall not be allowed.

(2) Any revocation of an election under Section 856(e)(5) of the Internal Revenue Code for federal purposes shall be treated for purposes of this part as a revocation of the election made by the real estate investment trust under Section 856(e)(5) of the Internal Revenue Code for state purposes and a separate election under paragraph (3) of subdivision (e) of Section 23051.5 shall not be allowed with respect to the property for any subsequent income year.

(3) If the real estate investment trust fails to make an election under Section 856(e)(5) of the Internal Revenue Code for federal purposes with respect to any property, that property shall not be treated for purposes of this part as foreclosure property, an election under Section 856(e)(5) of the Internal Revenue Code for state purposes with respect to that property shall not be allowed, and a separate election under paragraph (3) of subdivision (e) of Section 23051.5 shall not be allowed with respect to that property.

(c) This section shall apply to income years beginning after August 5, 1997.

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

SEC. 95. Section 24872.5 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

24872.5. (a) Section 856(c)(4) of the Internal Revenue Code shall not apply.

(b) (1) Section 856(c)(6)(G) of the Internal Revenue Code shall not apply and in lieu thereof paragraph (2) shall apply.

(2) Except to the extent provided by regulations of the Secretary of the Treasury under Section 856(c)(5)(G) of the Internal Revenue Code (as redesignated and amended by Public Law 105-34), both of the following shall be treated as income qualifying under Section 856(c)(2) of the Internal Revenue Code:

(A) Any payment to a real estate investment trust under an interest rate swap or cap agreement, option, futures contract, forward rate agreement, or any similar financial instrument, entered into by the trust in a transaction to reduce the interest rate risks with respect to any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets.

(B) Any gain from the sale or other disposition of any such investment.

(c) This section shall apply in determining whether an entity qualifies as a real estate investment trust for income years of that entity beginning after August 5, 1997.

(d) This section shall not apply to income years beginning on or after January 1, 1998.

SEC. 96. Section 24872.7 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

24872.7. (a) (1) (A) Whenever a penalty is imposed for federal purposes under Section 857(f)(2)(A) or (B) of the Internal Revenue Code, whichever is applicable, it shall be deemed that the real estate investment trust has failed to comply with the requirements of Section 857(f)(2)(A) or (B) of the Internal Revenue Code, whichever is applicable, for state purposes for that income year and a penalty equal to the penalty determined for federal purposes under Section 857(f)(2)(A) or (B) of the Internal Revenue Code, whichever is applicable, shall be imposed and shall be paid on notice and demand and in the same manner as tax.

(B) No penalty shall be imposed under this paragraph if the Secretary of the Treasury, under Section 857(f)(2)(D) of the Internal Revenue Code, has determined that the failure to comply is due to reasonable cause and not to willful neglect.

(2) (A) Whenever a penalty is imposed for federal purposes under Section 857(f)(2)(C) of the Internal Revenue Code it shall be deemed that the real estate investment trust has failed to comply with the requirements of Section 857(f)(2)(C) of the Internal Revenue Code for state purposes for that income year and an additional penalty equal to the penalty determined for federal purposes under Section 857(f)(2)(C) of the Internal Revenue Code shall be imposed and shall be paid on notice and demand and in the same manner as tax.

(B) No penalty shall be imposed under this paragraph if the Secretary of the Treasury, under Section 857(f)(2)(D) of the Internal Revenue Code, has determined that the failure to comply is due to reasonable cause and not to willful neglect.

(b) This section shall apply to income years beginning after August 5, 1997.

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

SEC. 97. Section 24875.5 of the Revenue and Taxation Code, as added by Chapter 7 of the Statutes of 1998, is amended to read:

24875.5. (a) Section 860L(b)(1)(A) of the Internal Revenue Code is modified by substituting the phrase ''on or after the startup date'' for the phrase ''after the startup date.''

(b) Section 860L(d)(2) of the Internal Revenue Code is modified by substituting a reference to Section 860I(b)(2) of the Internal Revenue Code in lieu of the reference to Section 860I(c)(2) of the Internal Revenue Code.

(c) This section shall apply on and after September 1, 1997.

(d) This section shall not apply to income years beginning on or after January 1, 1998.

SEC. 98. Section 24949.1 of the Revenue and Taxation Code, as added by Section 42 of Chapter 7 of the Statutes of 1998, is amended to read:

24949.1. (a) Section 1033(e) of the Internal Revenue Code, relating to livestock sold on account of drought, is modified by substituting the phrase ''on account of drought, flood, or other weather-related conditions'' in lieu of the phrase ''on account of drought'' contained therein.

(b) This section shall apply to sales and exchanges after December 31, 1996.

(c) This section shall not apply to income years beginning on or after January 1, 1998.

SEC. 99. Section 24954 of the Revenue and Taxation Code, as added by Chapter 604 of the Statutes of 1997, is repealed.

SEC. 100. Section 24954 of the Revenue and Taxation Code, as added by Chapter 611 of the Statutes of 1997, is amended to read:

24954. For income years beginning on or after January 1, 1995, Section 1042 of the Internal Revenue Code, relating to sales of stock to employee stock ownership plans or certain cooperatives, shall apply, except as otherwise provided.

SEC. 101. Section 24954.1 is added to the Revenue and Taxation Code, to read:

24954.1. Section 1042(g) of the Internal Revenue Code, relating to application of section to sales of stock in agricultural refiners and processors to eligible farm cooperatives, shall not apply.

SEC. 102. Section 24994 of the Revenue and Taxation Code is amended to read:

24994. Section 1272 of the Internal Revenue Code shall be modified as follows:

(a) For income years beginning on or after January 1, 1987, and before the income year in which the debt obligation matures or is sold, exchanged, or otherwise disposed, the amount included in gross income under this part shall be the same as the amount included in gross income on the federal tax return.

(b) The difference between the amount included in gross income on the federal return and the amount included in gross income under this part, with respect to obligations issued after December 31, 1984, for income years beginning before January 1, 1987, shall be included in gross income in the income year in which the debt obligation matures or is sold, exchanged, or otherwise disposed.

(c) A taxpayer may elect, in the form and manner as the Franchise Tax Board may prescribe,

(1) To recognize the difference specified in subdivision (b) ratably in each of the first four income years beginning on or after January 1, 1987, rather than at the time the debt obligation matures, is sold, exchanged, or otherwise disposed, or

(2) To apply the provisions of Section 1272 of the Internal Revenue Code to obligations issued on or after the first day of the taxpayer's income years beginning on or after January 1, 1987.

(d) Section 1004(b) of the Taxpayer Relief Act of 1997 (P.L. 105-34), relating to the effective date for determination of original issue discount where pooled debt obligations are subject to acceleration, is modified to provide that the changes to Section 1272(a)(6) of the Internal Revenue Code made by the act adding this subdivision shall apply to income years beginning on or after January 1, 1998, and the amount taken into account under Section 481 of the Internal Revenue Code shall be taken into account ratably over the four-income-year period beginning with the first income year beginning on or after January 1, 1998.

SEC. 103. Section 9551.1 is added to the Vehicle Code, to read:

9551.1. (a) When an application is made for a renewal or initial registration of a vehicle, the department shall apply the amount of the offset as established by paragraph (1) of subdivision (a) of Section 10754 of the Revenue and Taxation Code. The department shall alter its billing notices for vehicle license fees to indicate a total amount to be paid that reflects the amount of the offset. The Department of Motor Vehicles shall, as required by Section 11000.1 of the Revenue and Taxation Code, provide information to the Controller with respect to the amount of the offsets subject to this subdivision.

(b) (1) For purposes of this section, ''department'' means the Department of Motor Vehicles and the Department of Housing and Community Development.

(2) This section is inoperative on the date Section 9551.2 becomes operative, and is repealed on July 1, 1999.

SEC. 104. Section 9551.2 is added to the Vehicle Code, to read:

9551.2. (a) When an application is made for a renewal or initial registration of a vehicle, the department shall apply the amount of any operative offset established by subdivision (a) of Section 10754 of the Revenue and Taxation Code. The department shall alter its billing notice for vehicle license fees to indicate the amount of the vehicle license fee for each vehicle as calculated under Section 10752 or 10752.1 of the Revenue and Taxation Code, or under Section 18115 of the Health and Safety Code, and the amount of the applicable offset as required by subdivision (a) of Section 10754 of the Revenue and Taxation Code. The amount of the offset shall be identified on the billing notice as the ''VLF Offset.'' The Department of Motor Vehicles shall, as required by Section 11000 of the Revenue and Taxation Code, provide information to the Controller with respect to the amount of offsets subject to this subdivision.

(b) This section shall become operative on July 1, 1999, or on that earlier date that is determined by both the director of the department, and the Director of the Department of Housing and Community Development, to be feasible for the implementation of this section.

SEC. 105. Section 9554.1 is added to the Vehicle Code, to read:

9554.1. The amount of any penalty calculated pursuant to Section 9554 or subdivision (b) of Section 18116 of the Health and Safety Code shall be reduced by the amount of any offset implemented pursuant to Section 10754 of the Revenue and Taxation Code, or any portion of the amount of that offset.

SEC. 106. (a) The amendments made by this act to subdivision (a) of Section 18042 of, and to Sections 24611 and 24954 of, the Revenue and Taxation Code shall be operative for taxable and income years beginning on or after January 1, 1995.

(b) The Legislature finds and declares that the retroactive changes in taxation made by this act constitute a public purpose of statewide interest and concern because of all of the following:

(1) Employee stock ownership plans have broadened employee ownership of California businesses.

(2) Allowing taxpayers that offer employee stock ownership plan benefits to claim tax benefits in 1995 aids both California workers and businesses.

(3) The lack of conformity to federal tax law would otherwise subject taxpayers to undue recordkeeping burdens and costs of compliance, and because without that conformity employees in this state would be unable to obtain an ownership interest in their company. Moreover, continued conformity will ensure that incentives for the formation and maintenance of employee stock ownership plans in this state are provided.

SEC. 107. (a) It is the intent of the Legislature that in the case of Sections 17088.5, 17088.6, 17760.5, 18510, 19184, 23800.5, 24652.5, 24871.5, 24872.4, 27872.5, 24872.7, and 24875.5 of the Revenue and Taxation Code, which were added or amended by Chapter 7 of the Statutes of 1998 and amended by this act, the following rules shall apply in determining the applicability of these sections:

(1) For taxable and income years beginning before January 1, 1998, the section as contained in Chapter 7 of the Statutes of 1998 shall apply.

(2) For taxable and income years beginning on or after January 1, 1998, the section as contained in this act shall apply.

(b) Except as provided in paragraph (3), Sections 17062, 17132.6, 17559, 18037.3, 18572, 23456, 24661.5, and 24949.1 of the Revenue and Taxation Code which are contained in both this act and Chapter 7 of the Statutes of 1998 shall be applied in the following manner:

(1) For transactions occurring before January 1, 1998, the sections contained in Chapter 7 of the Statutes of 1998 shall apply.

(2) For transactions occurring on or after January 1, 1998, the sections contained in this act shall apply.

(3) This amendment to subparagraph (A) of paragraph (1) of subdivision (c) Section 17062 of the Revenue and Taxation Code made this act consistent with the intent of Chapter 7 of the Statutes of 1998, and as such, shall apply as provided in that act.

SEC. 108. It is the intent of the Legislature in enacting this act to better understand the relationship of directed tax credits to the creation of jobs in California.

SEC. 109. 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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