ASSEMBLY BILL No. 1843

Introduced by Assembly Member Ackerman

February 7, 2000

An act to amend Sections 17276, 17279.5, 18405, 18415, 18505, 18601, 18633.5, 18668, 19011, 19025, 19026, 19027, 19081, 19082, 19104, 19134, 19135, 19136, 19136.3, 19136.6, 19141.2, 19141.6, 19142, 19144, 19145, 19147, 19148, 19150, 19164, 19191, 19192, 19193, 19194, 19363, 19364, 19365, 19503, 19565, 21026, 23036, 23041, 23042, 23051.5, 23058, 23104, 23114, 23151, 23151.1, 23151.2, 23153, 23181, 23183, 23183.1, 23183.2, 23186, 23253, 23281, 23282, 23301, 23304.1, 23305.1, 23361, 23362, 23455, 23456, 23457, 23604, 23608, 23608.2, 23608.3, 23609, 23610, 23610.5, 23612.2, 23617, 23617.5, 23621, 23622.7, 23622.8, 23624, 23633, 23634, 23636, 23637, 23642, 23645, 23646, 23649, 23657, 23666, 23701a, 23701n, 23701s, 23703, 23704, 23731, 23735, 23736.3, 23736.4, 23737, 23771, 23772, 23774, 23775, 23777, 23800, 23801, 23802.5, 23803, 23804.5, 23806, 23811, 24273, 24273.5, 24275, 24276, 24306, 24307, 24308, 24322, 24324, 24343.3, 24343.5, 24343.7, 24344, 24344.5, 24344.7, 24345, 24346, 24347, 24347.5, 24348, 24349, 24351, 24354.1, 24355.5, 24356, 24356.5, 24356.6, 24356.7, 24356.8, 24357, 24357.2, 24357.7, 24357.9, 24358, 24360, 24361, 24362, 24363, 24364, 24377, 24383, 24402, 24404, 24409, 24410, 24415, 24416, 24416.2, 24416.4, 24416.5, 24416.6, 24424, 24425, 24434, 24436.1, 24436.5, 24438, 24442.5, 24448, 24602, 24611, 24631, 24632, 24633, 24633.5, 24634, 24636, 24637, 24654, 24667, 24673.2, 24674, 24675, 24676, 24676.5, 24677, 24678, 24685, 24690, 24692, 24710, 24871, 24871.5, 24872.4, 24872.5, 24872.7, 24905.5, 24916, 24918, 24943, 24944, 24945, 24946, 24949.1, 24952,

24954, 24955, 24956, 24990.4, 24990.7, 24994, 25101.3, 25105, 25108, 25110, 25111, 25111.1, 25112, 25124, 25129, 25131, 25132, 25134, and 25141 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 1843, as introduced, Ackerman. Bank and corporation taxes: income year.

The Bank and Corporation Tax Law, in general, imposes a franchise tax measured by the net income from California sources of the preceding calendar or fiscal year, which is referred to as the ''income year.'' The calendar or fiscal year for which the tax is imposed for the privilege of doing business in this state is referred to as the ''taxable year.''

This bill would, for calendar or fiscal years beginning on or after January 1, 2000, delete references to ''income year,'' and instead define ''taxable year'' as the calendar or fiscal year upon the basis of which the net income is computed.

Vote: majority. Appropriation: no. Fiscal committee: no. State-mandated local program: no.

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

1 SECTION 1. Section 17276 of the Revenue and
2 Taxation Code is amended to read:
3 17276. Except as provided in Sections 17276.1, 17276.2,
4 17276.4, 17276.5, and 17276.6, the deduction provided by
5 Section 172 of the Internal Revenue Code, relating to a
6 net operating loss deduction, shall be modified as follows:
7 (a) (1) Net operating losses attributable to taxable
8 years beginning before January 1, 1987, shall not be
9 allowed.
10 (2) A net operating loss shall not be carried forward to
11 any taxable year beginning before January 1, 1987.
12 (b) (1) Except as provided in paragraphs (2) and (3),
13 the provisions of Section 172(b)(2) of the Internal
14 Revenue Code, relating to the amount of carryovers, shall
15 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~~ *taxable* 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 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 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, 17276.2, 17276.4, 17276.5, and 17276.6.

(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. 2. 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~~ *taxable* 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. 3. Section 18405 of the Revenue and Taxation Code is amended to read:

18405. (a) In the case of a new statutory provision in Part 7.5 (commencing with Section 13201), Part 10 (commencing with Section 17001), Part 10.2 (commencing with Section 18401), or Part 11 (commencing with Section 23001), or the addition of a new part, the Franchise Tax Board itself is authorized to grant relief as set forth in subdivision (b) from the requirements of the new statutory provision in a manner as provided in subdivision (c).

(b) The relief provided in subdivision (a) may be granted only for the first taxable ~~or income~~ year for which the new statutory provision is operative and only when

substantial unintentional noncompliance with the new provision has occurred by a class of affected taxpayers. The relief is limited to waiving penalties or perfecting elections and may be granted only to taxpayers who timely paid taxes and other required amounts shown on the return consistent with the election and who timely filed their return (with regard to extension).

(c) The relief granted in this section shall, upon the recommendation of the executive officer of the Franchise Tax Board, be made by resolution of the Franchise Tax Board which sets forth the conditions, time, and manner as the Franchise Tax Board determines are necessary. The resolution shall be adopted only by an affirmative vote of each of the three members of the Franchise Tax Board.

(d) For purposes of this section:

(1) ‘‘New statutory provision’’ means a complete, newly established tax program, tax credit, exemption, deduction, exclusion, penalty, or reporting or payment requirement and does not mean amendments made to existing tax provisions that make minor modifications or technical changes.

(2) ‘‘Perfecting elections’’ includes correcting omissions or errors only when substantial evidence is present with the filed return that the taxpayer intended to make the election and does not include making an election where one was not previously attempted to be made.

(3) ‘‘Substantial unintentional noncompliance,’’ for purposes of Part 11 (commencing with Section 23001), includes any case in which the taxpayer filed a water’s-edge contract with a timely filed original return and timely paid all taxes and other required amounts shown on the return consistent with the water’s-edge election, but where the taxpayer’s election is or might be invalidated by reason of the act or omission of an affiliated corporation that is not the parent or a subsidiary of the taxpayer. In that case, notwithstanding anything to the contrary in this section, relief shall be deemed granted to validate the taxpayer’s water’s-edge election,

conditioned only upon an agreement by the affiliated corporation to either (A) file a water's-edge contract and pay all taxes and other required amounts consistent with that election, or (B) waive any right, with respect to any ~~income~~ *taxable* year for which the corporation did not make a water's-edge election on its own timely filed return, to determine its income derived from or attributable to sources within this state pursuant to that election, whichever measure produces the greater amount of tax.

(e) This section shall apply to any Franchise Tax Board resolution adopted after the effective date of this section with respect to any taxable ~~or income~~ year which is subject to an open statute of limitations on the date of the resolution.

(f) On or before March 1, 1995, the Franchise Tax Board shall report to the Legislature on the utilization of this section. The report shall describe the class or classes of taxpayers provided relief, the issue involved and the number of taxpayers affected, and, where applicable, the aggregate amount of penalty relieved for each class of taxpayers.

SEC. 4. Section 18415 of the Revenue and Taxation Code is amended to read:

18415. Unless otherwise specifically provided therein, the provisions of any act:

(a) That affect the imposition or computation of taxes, additions to tax other than Sections 19136 or 19142, penalties, or the allowance of credits against the tax, shall be applied to taxable ~~(or income)~~ years beginning on or after January 1 of the year in which the act takes effect.

(b) That change the provisions of Sections 19023 to 19027, inclusive, (relating to payment of estimated tax) or Section 19136 or Sections 19142 to 19151, inclusive, (relating to underpayment of estimated tax) shall be applied to taxable ~~(or income)~~ years beginning on or after January 1 of the year immediately after the year in which the act takes effect.

(c) That otherwise affect the provisions of this part shall be applied on and after the date the act takes effect.

SEC. 5. 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. 6. Section 18601 of the Revenue and Taxation Code is amended to read:

18601. (a) Except as provided in subdivision (b) or (c), every taxpayer subject to the tax imposed by Part 11 (commencing with Section 23001) shall, on or before the 15th day of the third month following the close of its ~~income~~ *taxable* year, transmit to the Franchise Tax Board a return in a form prescribed by it, specifying for the ~~income~~ *taxable* year, all the facts as it may by rule, or otherwise, require in order to carry out this part. A tax return, disclosing net income for any ~~income~~ *taxable* year, filed pursuant to Chapter 2 (commencing with Section 23101) or Chapter 3 (commencing with Section 23501) of Part 11 shall be deemed filed pursuant to the proper chapter of Part 11 for the same ~~income~~ *taxable* period, if the chapter under which the return is filed is determined erroneous.

(b) In the case of cooperative associations described in Section 24404, returns shall be filed on or before the 15th day of the ninth month following the close of its ~~income~~ *taxable* year.

(c) In the case of taxpayers required to file a return for a short period under Section 24634, the due date for the short period return shall be the same as the due date of the federal tax return that includes the net income of the taxpayer for that short period, or the due date specified in subdivision (a) if no federal return is required to be

filed that would include the net income for that short period.

(d) For ~~income~~ *taxable* years beginning on or after January 1, 1997, each ''S corporation'' required to file a return under subdivision (a) for any ~~income~~ *taxable* year shall, on or before the day on which the return for the ~~income~~ *taxable* year was filed, furnish each person who is a shareholder at any time during the ~~income~~ *taxable* year a copy of the information shown on the return.

(e) For taxable ~~or income~~ years beginning on or after January 1, 1997:

(1) A shareholder of an ''S corporation'' shall, on the shareholder's return, treat a Subchapter S item in a manner that is consistent with the treatment of the item on the corporate return.

(2) (A) In the case of any Subchapter S item, paragraph (1) shall not apply to that item if both of the following occur:

(i) Either of the following occurs:

(I) The corporation has filed a return, but the shareholder's treatment of the item on the shareholder's return is, or may be, inconsistent with the treatment of the item on the corporate return.

(II) The corporation has not filed a return.

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

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

(i) Demonstrates to the satisfaction of the Franchise Tax Board that the treatment of the Subchapter S item on the shareholder's return is consistent with the treatment of the item on the schedule furnished to the shareholder by the corporation.

(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), and in which the shareholder does not comply with clause (ii) of

subparagraph (A) of paragraph (2), any adjustment required to make the treatment of the items by the shareholder consistent with the treatment of the items on the corporate return shall be treated as arising out of a mathematical error and assessed and collected under Section 19051.

(4) For purposes of this subdivision, ''Subchapter S item'' means any item of an ''S corporation'' to the extent provided by regulations that, for purposes of Part 10 (commencing with Section 17001) or this part, the item is more appropriately determined at the corporation level than at the shareholder level.

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

SEC. 7. Section 18633.5 of the Revenue and Taxation Code is amended to read:

18633.5. (a) Every limited liability company which is classified as a partnership for California tax purposes that is doing business in this state, organized in this state, or registered with the Secretary of State shall file its return on or before the fifteenth day of the fourth month following the close of its taxable year, shall make a return for that taxable year, stating specifically the items of gross income and the deductions allowed by Part 10 (commencing with Section 17001). The return shall include the names, addresses, and taxpayer identification numbers of the persons, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each person. The return shall contain or be verified by a written declaration that it is made under the penalties of perjury, signed by one of the limited liability company members. In the case of a limited liability company not doing business in this state, and subject to the tax imposed by subdivision (b) of Section 17941 or 23091, the Franchise Tax Board shall, for returns required to be filed on or after January 1, 1998, prescribe the

manner and extent to which the information identified in this subdivision shall be included with the return required by this subdivision.

(b) Each limited liability company required to file a return under subdivision (a) for any limited liability company taxable ~~or income~~ year shall, on or before the day on which the return for that taxable ~~or income~~ year was required to be filed, furnish to each person who holds an interest in that limited liability company at any time during that taxable or ~~income year~~ a copy of that information required to be shown on that return as may be required by forms and instructions prescribed by the Franchise Tax Board.

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

(1) Furnish to the limited liability company, in the manner prescribed by the Franchise Tax Board, the name, address, and taxpayer identification number of that person, and any other information for that taxable ~~or income~~ year as the Franchise Tax Board may prescribe by forms and instructions.

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

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

(e) (1) A limited liability company shall file with its return required under subdivision (a), in the form required by the Franchise Tax Board, the agreement of each nonresident member to file a return pursuant to Section 18501, to make timely payment of all taxes imposed on the member by this state with respect to the income of the limited liability company, and to be subject to personal jurisdiction in this state for purposes of the collection of income taxes, together with related interest and penalties, imposed on the member by this state with respect to the income of the limited liability company. If

the limited liability company fails to timely file the agreements on behalf of each of its nonresident members, then the limited liability company shall, at the time set forth in subdivision (f), pay to this state on behalf of each nonresident member of whom an agreement has not been timely filed an amount equal to the highest marginal tax rate in effect under Section 17041, in the case of members which are individuals, estates, or trusts, and Section 23151, in the case of members which are corporations, multiplied by the amount of the member's distributive share of the income source to the state reflected on the limited liability company's return for the taxable period. A limited liability company shall be entitled to recover the payment made from the member on whose behalf the payment was made.

(2) If a limited liability company fails to attach the agreement or to timely pay the payment required by paragraph (1), the payment shall be considered the tax of the limited liability company for purposes of the penalty prescribed by Section 19132 and interest prescribed by Section 19101 for failure to timely pay the tax. Payment of the penalty and interest imposed on the limited liability company for failure to timely pay the amount required by this subdivision shall extinguish the liability of a nonresident member for the penalty and interest for failure to make timely payment of all taxes imposed on that member by this state with respect to the income of the limited liability company.

(3) No penalty or interest shall be imposed on the limited liability company under paragraph (2) if the nonresident member timely files and pays all taxes imposed on the member by this state with respect to the income of the limited liability company.

(f) Any agreement of a nonresident member required to be filed pursuant to subdivision (e) shall be filed at either of the following times:

(1) The time the annual return is required to be filed pursuant to this section for the first taxable period for which the limited liability company became subject to tax

pursuant to Chapter 10.6 (commencing with Section 17941) or Chapter 1.6 (commencing with Section 23091).

(2) The time the annual return is required to be filed pursuant to this section for any taxable period in which the limited liability company had a nonresident member on whose behalf an agreement described in subdivision (e) has not been previously filed.

(g) Any amount paid by the limited liability company to this state pursuant to paragraph (1) of subdivision (e) shall be considered to be a payment by the member on account of the income tax imposed by this state on the member for the taxable period.

(h) Every limited liability company that is classified as a corporation for California tax purposes shall be subject to the requirement to file a tax return under the provisions of Part 10.2 (commencing with Section 18401) and the applicable taxes imposed by Part 11 (commencing with Section 23001) including Section 23221 relating to the prepayment of the minimum tax to the Secretary of State.

(i) (1) Every limited liability company doing business in this state, organized in this state, or registered with the Secretary of State, that is disregarded pursuant to Section 23038 shall file a return that includes information necessary to verify its liability under Sections 17941 and 17942, provides its sole owner's name and taxpayer identification number, includes the consent of the owner to California tax jurisdiction, and includes other information necessary for the administration of this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001).

(2) If the owner's consent required under paragraph (1) is not included, the limited liability company shall pay on behalf of its owner an amount consistent with, and treated the same as, the amount to be paid under subdivision (e) by a limited liability company on behalf of a nonresident member for whom an agreement required by subdivision (e) is not attached to the return of the limited liability company.

(3) The return required under paragraph (1) shall be filed on or before the fifteenth day of the fourth month after the close of the taxable year of the owner or on or before the fifteenth day of the third month after the close of the ~~income~~ *taxable* year of the owner *subject to tax under Chapter 2 (commencing with Section 23101) of Part 11*, whichever is applicable.

(4) For limited liability companies disregarded pursuant to Section 23038, ''taxable ~~or income~~ year of the owner'' shall be substituted for ''taxable year'' in Sections 17941 and 17942.

SEC. 8. Section 18668 of the Revenue and Taxation Code is amended to read:

18668. (a) Every person required under this article to deduct and withhold any tax is hereby made liable for that tax, to the extent provided by this section and, insofar as they are not inconsistent with this article, all the provisions of this part relating to penalties, interest, assessment, and collections shall apply to persons subject to this part, and for these purposes any amount required to be deducted and paid to the Franchise Tax Board under this article shall be considered the tax of the person. Any person who fails to withhold from any payments any amount required to be withheld under this article is liable for the amount withheld or the amount of taxes due from the taxpayer to whom the payments are made but not in excess of the amount required to be withheld, whichever is more, unless it is shown that the failure to withhold is due to reasonable cause.

(b) If any amount required to be withheld under this article is not paid to the Franchise Tax Board on or before the due date required by regulations, interest shall be assessed at the adjusted annual rate established pursuant to Section 19521, computed from the due date to the date paid.

(c) Whenever any person has withheld any amount pursuant to this article, the amount so withheld shall be held to be a special fund in trust for the State of California.

(d) In lieu of the amount provided for in subdivision (a), unless it is shown that the failure to withhold is due

to reasonable cause, whenever any transferee is required to withhold any amount pursuant to subdivision (e) of Section 18662, the transferee is liable for the greater of the following amounts for failure to withhold only after the transferee, as specified, is notified in writing of the requirements under subdivision (e) of Section 18662:

(1) Five hundred dollars ($500).

(2) Ten percent of the amount required to be withheld under subdivision (e) of Section 18662.

(e) (1) Unless it is shown that the failure to notify is due to reasonable cause, the real estate escrow person shall be liable for the amount specified in subdivision (d), when written notification of the withholding requirements of subdivision (e) of Section 18662 is not provided to the transferee and the California real property disposition is subject to withholding under subdivision (e) of Section 18662.

(2) The real estate escrow person shall provide written notification to the transferee in substantially the same form as follows:

''In accordance with Section 18662 of the Revenue and Taxation Code, a buyer may be required to withhold an amount equal to $3^1/_3$ percent of the sales price in the case of a disposition of California real property interest by either:

1. A seller who is an individual with a last known street address outside of California or when the disbursement instructions authorize the proceeds to be sent to a financial intermediary of the seller, OR

2. A corporate seller which has no permanent place of business in California.

The buyer may become subject to penalty for failure to withhold an amount equal to the greater of 10 percent of the amount required to be withheld or five hundred dollars ($500).

However, notwithstanding any other provision included in the California statutes referenced above, no buyer will be required to withhold any amount or be subject to penalty for failure to withhold if:

1. The sales price of the California real property conveyed does not exceed one hundred thousand dollars ($100,000), OR

2. The seller executes a written certificate, under the penalty of perjury, certifying that the seller is a resident of California, or if a corporation, has a permanent place of business in California, OR

3. The seller, who is an individual, executes a written certificate, under the penalty of perjury, that the California real property being conveyed is the seller's principal residence (as defined in Section 1034 of the Internal Revenue Code).''

The seller is subject to penalty for knowingly filing a fraudulent certificate for the purpose of avoiding the withholding requirement.

The California statutes referenced above include provisions which authorize the Franchise Tax Board to grant reduced withholding and waivers from withholding on a case-by-case basis.

(3) The real estate escrow person shall not be liable under this subdivision, if the tax due as a result of the disposition of California real property is paid by the original or extended due date of the transferor's return for the taxable ~~or income~~ year in which the disposition occurred.

(4) The real estate escrow person and the transferee shall not be liable under paragraph (1) or subdivision (d), if the failure to withhold is the result of the real estate escrow person's reliance, based on good faith and on all the information of which he or she has knowledge, upon a written certificate executed by the transferor under penalty of perjury certifying to any of the following:

(A) That the transferor is a resident of California.

(B) That the California real property being conveyed is the principal residence of the transferor within the meaning of Section 1034 of the Internal Revenue Code.

(C) The transferor, if a corporation, has a permanent place of business in California.

(5) Any transferor who for the purpose of avoiding the withholding requirements of subdivision (e) of Section 18662 knowingly executes a false certificate pursuant to this subdivision shall be liable for twice the amount specified in subdivision (d).

(6) Unless the failure to notify is due to willful disregard of the withholding requirements of subdivision (e) of Section 18662, the real estate escrow person shall not be liable under this subdivision if the disposition of California real property occurs prior to July 1, 1991.

(f) The amount of tax required to be deducted and withheld under this article shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes imposed by Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

SEC. 9. Section 19011 of the Revenue and Taxation Code is amended to read:

19011. (a) All payments required under this part, regardless of the ~~income (or taxable)~~ *taxable* year to which the payments apply shall be remitted to the Franchise Tax Board by electronic funds transfer pursuant to Division 11 (commencing with Section 11101) of the Commercial Code, once any of the following conditions are met:

(1) With respect to any corporation, any installment payment of estimated tax made pursuant to Section 19025 or the payment made pursuant to Section 18604 with regard to an extension of time to file exceeds fifty thousand dollars ($50,000) in any ~~income~~ *taxable* year beginning on or after January 1, 1991, or exceeds twenty thousand dollars ($20,000) in any ~~income~~ *taxable* year beginning on or after January 1, 1995.

(2) With respect to any corporation, the total tax liability exceeds two hundred thousand dollars ($200,000) in any ~~income~~ *taxable* year beginning on or after January 1, 1991, or exceeds eighty thousand dollars ($80,000) in any ~~income~~ *taxable* year beginning on or after January 1, 1995. For purposes of this section, total tax liability shall

be the total tax liability as shown on the original return, after any adjustment made pursuant to Section 19051.

(3) A taxpayer submits a request to the Franchise Tax Board and is granted permission to make electronic funds transfers.

(b) A taxpayer required to remit payments to the Franchise Tax Board by electronic funds transfer may elect to discontinue making payments where the threshold requirements set forth in paragraphs (1) and (2) of subdivision (a) were not met for the preceding ~~income (or taxable)~~ *taxable* year. The election shall be made in a form and manner prescribed by the Franchise Tax Board.

(c) Any taxpayer required to remit payment by electronic funds transfer pursuant to this section who makes payment by other means shall pay a penalty of 10 percent of the amount paid, unless it is shown that the failure to make payment as required was for reasonable cause and was not the result of willful neglect.

(d) Any taxpayer required to remit payments by electronic funds transfer pursuant to this section may request a waiver of those requirements from the Franchise Tax Board. The Franchise Tax Board may grant a waiver only if it determines that the particular amounts paid in excess of the threshold amounts established in this section were not representative of the taxpayer's tax liability. If a taxpayer is granted a waiver, subsequent remittances by electronic funds transfer shall be required only on those terms set forth in the waiver.

(e) The Franchise Tax Board shall accept remittances by electronic funds transfer pursuant to this section no later than January 1, 1993. Electronic funds transfer procedures, in addition to those described in subdivision (f), shall be as prescribed by the Franchise Tax Board. Payment is deemed complete on the date the electronic funds transfer is initiated, if settlement to the state's demand account occurs on or before the banking day following the date the transfer is initiated. If settlement to the state's demand account does not occur on or before the banking day following the date the transfer is

initiated, payment is deemed to occur on the date settlement occurs.

(f) For purposes of this section:

(1) ‘‘Electronic funds transfer’’ means any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, that is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape, so as to order, instruct, or authorize a financial institution to debit or credit an account. Electronic funds transfer shall be accomplished by an automated clearinghouse debit, automated clearinghouse credit, a Federal Reserve Wire Transfer (Fedwire), or by an international funds transfer.

(2) ‘‘Automated clearinghouse’’ means any federal reserve bank, or an organization established by agreement with the National Automated Clearing House Association, that operates as a clearinghouse for transmitting or receiving entries between banks or bank accounts and that authorizes an electronic transfer of funds between those banks or bank accounts.

(3) ‘‘Automated clearinghouse debit’’ means a transaction in which any department of the state, through its designated depository bank, originates an automated clearinghouse transaction debiting the taxpayer’s bank account and crediting the state’s bank account for the amount of tax. Banking costs incurred for the automated clearinghouse debit transaction by the taxpayer shall be paid by the state.

(4) ‘‘Automated clearinghouse credit’’ means an automated clearinghouse transaction in which the taxpayer, through its own bank, originates an entry crediting the state’s bank account and debiting its own bank account. Banking costs incurred by the state for the automated clearinghouse credit transaction may be charged to the taxpayer.

(5) ‘‘Fedwire’’ means any transaction originated by the taxpayer and utilizing the national electronic payment system to transfer funds through federal reserve banks, pursuant to which the taxpayer debits its own bank account and credits the state’s bank account. Electronic

funds transfers may be made by Fedwire only if prior approval is obtained from the Franchise Tax Board and the taxpayer is unable, for reasonable cause, to make payments pursuant to paragraph (3) or (4). Banking costs charged to the taxpayer and to the state may be charged to the taxpayer.

(6) ''International funds transfer'' means any transaction originated by the taxpayer and utilizing the international electronic payment system to transfer funds, pursuant to which the taxpayer debits its own bank account and credits the state's bank account.

(7) In determining whether a payment or total tax liability exceeds the amounts established in subdivision (a), the income of all taxpayers whose income derived from, or attributable to, sources within this state is required to be determined by a combined report shall be aggregated and the total aggregate amount shall be considered to be the income of a single taxpayer for purposes of determining the payment or total tax liability of a single taxpayer.

SEC. 10. Section 19025 of the Revenue and Taxation Code is amended to read:

19025. (a) If the amount of estimated tax does not exceed the minimum tax specified by Section 23153, the entire amount of the estimated tax shall be due and payable on or before the 15th day of the fourth month of the ~~income~~ *taxable* year.

(b) Except as provided in subdivision (c), if the amount of estimated tax exceeds the minimum tax specified by Section 23153, the amount payable shall be paid in installments as follows:

If the requirements of this subdivision are first met—	The following percentages of the estimated tax shall be paid on the 15th day of the—			
	4th month	6th month	9th month	12th month
Before the 1st day of the 4th month of the ~~income~~ *taxable* year	25 (but not less than the minimum tax provided in Section 23153 and any tax under Section 23800.5)	25	25	25
After the last day of the 3rd month and before the 1st day of the 6th month of the ~~income~~ *taxable* year	——	$33^1/_3$	$33^1/_3$	$33^1/_3$

After the last day of the 5th month and before the 1st day of the 9th month of the ~~income~~ *taxable* year	____	____	50	50
After the last day of the 8th month and before the 1st day of the 12th month of the ~~income~~ *taxable* year	____	____	____	100

(c) If a wholly owned subsidiary is first subject to tax under Section 23800.5 after the last day of the third month of the ~~income~~ *taxable* year of owner, the amount of the next installment of estimated tax under subdivision (b) after the wholly owned subsidiary is subject to tax under Section 23800.5 shall not be less than the amount of the tax of the wholly owned subsidiary under Section 23800.5 and an amount equal to that amount shall be due and payable on the date the installment is required to be paid. For purposes of determining which installment is the next installment of estimated tax under subdivision (b), subdivision (b) shall be modified by substituting ‘‘includes the tax of a wholly owned subsidiary under Section 23800.5’’ for ‘‘exceeds the minimum tax specified by Section 23153.’’

SEC. 11. Section 19026 of the Revenue and Taxation Code is amended to read:

19026. If, after paying any installment of estimated tax required by subdivision (b) of Section 19025, the taxpayer makes a new estimate, the amount of each remaining installment (if any) shall be the amount which would have been payable if the new estimate had been made when the first estimate for the ~~income~~ *taxable* year was

made, increased or decreased (as the case may be) by the amount computed by dividing—

(a) The difference between—

(1) The amount of estimated tax required to be paid before the date on which the new estimate is made, and

(2) The amount of estimated tax which would have been required to be paid before that date if the new estimate had been made when the first estimate was made, by

(b) The number of installments remaining to be paid on or after the date on which the new estimate is made.

SEC. 12. Section 19027 of the Revenue and Taxation Code is amended to read:

19027. The application of this article to ~~income~~ *taxable* years of less than 12 months shall be in accordance with regulations prescribed by the Franchise Tax Board.

SEC. 13. Section 19081 of the Revenue and Taxation Code is amended to read:

19081. If the Franchise Tax Board finds that the assessment or the collection of a tax or a deficiency for any year, current or past, will be jeopardized in whole or in part by delay, it may mail or issue notice of its findings to the taxpayer, or its transferee or transferees, together with a demand for immediate payment of the tax or the deficiency declared to be in jeopardy, including interest and penalties and additions thereto. Any assessment issued under this article shall also be an assessment issued pursuant to Section 19033, if an assessment has not already been issued pursuant to Section 19033 with respect to that taxable ~~or income~~ year for that amount.

SEC. 14. Section 19082 of the Revenue and Taxation Code is amended to read:

19082. In the case of a tax for a current period, if the Franchise Tax Board finds that the assessment or collection of the tax will be jeopardized in whole or in part by delay, the Franchise Tax Board may declare the ~~income or~~ taxable period of the taxpayer immediately terminated. The Franchise Tax Board shall mail or issue notice of its finding and declaration to the taxpayer, together with a demand for a return and immediate

payment of the tax based on the period declared terminated, including therein income accrued and deductions incurred up to the date of termination if not otherwise properly includible or deductible in respect of the period, and the tax shall be immediately due and payable whether or not the time otherwise allowed by law for filing the return and paying the tax has expired.

SEC. 15. Section 19104 of the Revenue and Taxation Code is amended to read:

19104. (a) Interest upon the amount assessed as a deficiency shall be assessed, collected, and paid in the same manner as the tax at the adjusted annual rate established pursuant to Section 19521 from the date prescribed for the payment of the tax or, if the tax is paid in installments, from the date prescribed for payment of the first installment, until the date the tax is paid. If any portion of the deficiency is paid prior to the date it is assessed, interest shall accrue on that portion only to the date paid.

(b) If the Franchise Tax Board makes or allows a refund or credit that it determines to be erroneous, in whole or in part, the amount erroneously made or allowed may be assessed and collected after notice and demand pursuant to Section 19051 (pertaining to mathematical errors), except that the rights of protest and appeal shall apply with respect to amounts assessable as deficiencies without regard to the running of any period of limitations provided elsewhere in this part. Notice and demand for repayment must be made within two years after the refund or credit was made or allowed, or during the period within which the Franchise Tax Board may mail a notice of proposed deficiency assessment, whichever period expires the later. Interest on amounts erroneously made or allowed shall not accrue until 30 days from the date the Franchise Tax Board mails a notice and demand for repayment as provided by this subdivision.

(c) (1) In the case of any assessment of interest, the Franchise Tax Board may abate the assessment of all or

any part of that interest for any period in any of the following circumstances:

(A) Any deficiency attributable in whole or in part to any unreasonable error or delay by an officer or employee of the Franchise Tax Board (acting in his or her official capacity) in performing a ministerial or managerial act.

(B) Any payment of any tax described in Section 19033 to the extent that any delay in that payment is attributable to that officer or employee being dilatory in performing a ministerial or managerial act.

(C) Any interest accruing from a deficiency based on a final federal determination of tax, for the same period that interest was abated on the related federal deficiency amount under Section 6404(e) of the Internal Revenue Code, and the error or delay occurred on or before the issuance of the final federal determination. This subparagraph shall apply to any ministerial act for which the interest accrued after September 25, 1987, or for any managerial act applicable to a taxable ~~or income~~ year beginning on or after January 1, 1998, for which the Franchise Tax Board may propose an assessment or allow a claim for refund.

(D) For purposes of this paragraph:

(i) Except as provided in subparagraph (C), an error or delay shall be taken into account only if no significant aspect of that error or delay can be attributed to the taxpayer involved and after the Franchise Tax Board has contacted the taxpayer in writing with respect to that deficiency or payment.

(ii) Within 180 days after the Franchise Tax Board mails its notice of determination not to abate interest, a taxpayer may appeal the Franchise Tax Board's determination to the State Board of Equalization. The State Board of Equalization shall have jurisdiction over the appeal to determine whether the Franchise Tax Board's failure to abate interest under this section was an abuse of discretion, and may order an abatement.

(iii) Except for the amendment adding clause (ii), the amendments made by the act adding this clause are operative with respect to taxable ~~or income~~ years

beginning on or after January 1, 1998. The amendment adding clause (ii) is operative for requests for abatement made on or after January 1, 1998.

(2) The Franchise Tax Board shall abate the assessment of all interest on any erroneous refund for which an action for recovery is provided under Section 19411 until 30 days after the date demand for repayment is made, unless either of the following has occurred:

(A) The taxpayer (or a related party) has in any way caused that erroneous refund.

(B) That erroneous refund exceeds fifty thousand dollars ($50,000).

SEC. 16. Section 19134 of the Revenue and Taxation Code is amended to read:

19134. (a) The provisions of Section 6657 of the Internal Revenue Code, relating to bad checks, shall apply except as otherwise provided.

(b) Section 6657 of the Internal Revenue Code, relating to bad checks, is modified to apply to payments made by credit card remittance or electronic funds transfer (as provided by Section 19011) in addition to payments made by check or money order.

(c) For payments received prior to January 1, 1993, this section shall be applied only to payments pertaining to taxable ~~(or income)~~ years beginning on or after January 1, 1990.

(d) For payments received on or after January 1, 1993, this section shall be applied to all payments, without regard to taxable ~~(or income)~~ year.

SEC. 17. Section 19135 of the Revenue and Taxation Code is amended to read:

19135. Whenever any foreign corporation which fails to qualify to do business in this state or whose powers, rights, and privileges have been forfeited, or any domestic corporation which has been suspended, and which is doing business in this state, within the meaning of Section 23101, fails to make and file a return as required by this part, the Franchise Tax Board shall impose a penalty of two thousand dollars ($2,000) per ~~income~~ *taxable* year, unless the failure to file is due to reasonable

cause and not willful neglect. The penalty shall be in addition to any other penalty which may be due under this part. The penalty shall be imposed if the return is not filed within 60 days after the Franchise Tax Board sends the taxpayer a notice and demand to file the required tax return.

SEC. 18. 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:~~ *applies:*

(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. 19. Section 19136.3 of the Revenue and Taxation Code is amended to read:

19136.3. (a) No addition to tax shall be made under Section 19136 for any period before April 16, 1998, with respect to any underpayment of an installment for the 1997 or 1998 taxable year, to the extent that the underpayment was created or increased by any provision of the act adding or amending this section.

(b) No addition to tax shall be made under Section 19142 for any period before April 16, 1998, with respect to any underpayment of an installment for the 1997 or 1998 ~~income~~ *taxable* year, to the extent that the underpayment was created or increased by any provision of the act adding or amending this section.

(c) The Franchise Tax Board shall adopt procedures, forms, and instructions necessary to implement this section in a reasonable manner.

SEC. 20. Section 19136.6 of the Revenue and Taxation Code is amended 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~~ *taxable* 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. 21. 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~~ *taxable* 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~~ *taxable* years beginning before January 1, 1998.

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

SEC. 22. Section 19141.6 of the Revenue and Taxation Code is amended to read:

19141.6. (a) Each taxpayer determining its income subject to tax pursuant to Section 25101 or electing to file pursuant to Section 25110 shall, for ~~income~~ *taxable* years beginning on or after January 1, 1994, maintain (in the location, in the manner, and to the extent prescribed in regulations promulgated by the Franchise Tax Board on or before December 31, 1995) and make available upon request all of the following:

(1) Any records as may be appropriate to determine the correct treatment of the components that are a part of one or more unitary businesses for purposes of determining the income derived from or attributable to this state pursuant to Section 25101 or 25110.

(2) Any records as may be appropriate to determine the correct treatment of amounts that are attributable to the classification of an item as business or nonbusiness income for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(3) Any records as may be appropriate to determine the correct treatment of the apportionment factors for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(4) Documents and information, including any questionnaires completed and submitted to the Internal Revenue Service, that are necessary to audit issues

involving attribution of income to the United States or foreign jurisdictions under Section 882 of, or Subpart F of Part III of Subchapter N of, or similar provisions of, the Internal Revenue Code.

(b) For purposes of this section:

(1) Information for any year shall be retained for that period of time in which the taxpayers' income or franchise tax liability to this state may be subject to adjustment, including all periods in which additional income or franchise taxes may be assessed, not to exceed eight years from the due date or extended due date of the return, or during which a protest is pending before the Franchise Tax Board, or an appeal is pending before the State Board of Equalization, or a lawsuit is pending in the courts of this state or the United States with respect to California franchise or income tax.

(2) ''Related party'' means corporations that are related because one owns or controls, directly or indirectly, more than 50 percent of the stock of the other or because more than 50 percent of the voting stock of each is owned or controlled, directly or indirectly, by the same interests.

(3) ''Records'' includes any books, papers, or other data.

(c) (1) If a corporation subject to this section fails to maintain or fails to cause another to maintain records as required by subdivision (a), that corporation shall pay a penalty of ten thousand dollars ($10,000) for each ~~income~~ *taxable* year with respect to which the failure occurs.

(2) If any failure described in paragraph (1) continues for more than 90 days after the day on which the Franchise Tax Board mails notice of the failure to the corporation, that corporation shall pay a penalty (in addition to the amount required under paragraph (1)) of ten thousand dollars ($10,000) for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period. The additional penalty imposed by this subdivision shall not exceed a maximum of fifty thousand dollars ($50,000) if the failure to maintain or the failure to cause another to maintain is

not willful. This maximum shall apply with respect to ~~income~~ *taxable* years beginning on or after January 1, 1994, and before the earlier of the first day of the month following the month in which regulations are adopted pursuant to this section or December 31, 1995.

(3) For purposes of this section, the time prescribed by regulations to maintain records (and the beginning of the 90-day period after notice by the Franchise Tax Board) shall be treated as not earlier than the last day on which (as shown to the satisfaction of the Franchise Tax Board) reasonable cause existed for failure to maintain the records.

(d) (1) The Franchise Tax Board may apply the rules of paragraph (2) whether or not the board begins a proceeding to enforce a subpoena, or subpoena duces tecum, if subparagraphs (A), (B), and (C) apply:

(A) For purposes of determining the correct treatment under Part 11 (commencing with Section 23001) of the items described in subdivision (a), the Franchise Tax Board issues a subpoena or subpoena duces tecum to a corporation to produce (either directly or as agent for the related party) any records or testimony.

(B) The subpoena or subpoena duces tecum is not quashed in a proceeding begun under paragraph (3) and is not determined to be invalid in a proceeding begun under Section 19504 to enforce the subpoena or subpoena duces tecum.

(C) The corporation does not substantially comply in a timely manner with the subpoena or subpoena duces tecum and the Franchise Tax Board has sent by certified or registered mail a notice to that corporation that it has not substantially complied.

(D) If the corporation fails to maintain or fails to cause another to maintain records as required by subdivision (a), and by reason of that failure, the subpoena, or subpoena duces tecum, is quashed in a proceeding described in subparagraph (B) or the corporation is not able to provide the records requested in the subpoena or subpoena duces tecum, the Franchise Tax Board may

apply the rules of paragraph (2) to any of the items described in subdivision (a) to which the records relate.

(2) (A) All of the following shall be determined by the Franchise Tax Board in the Franchise Tax Board's sole discretion from the Franchise Tax Board's own knowledge or from information the Franchise Tax Board may obtain through testimony or otherwise:

(i) The components that are a part of one or more unitary businesses for purposes of determining the income derived from or attributable to this state pursuant to Section 25101 or 25110.

(ii) Amounts that are attributable to the classification of an item as business or nonbusiness income for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(iii) The apportionment factors for purposes of Article 2 (commencing with Section 25120) of Chapter 17 of Part 11.

(iv) The correct amount of income under Section 882 of, or Subpart F of Part III of Subchapter N of, or similar provisions of, the Internal Revenue Code.

(B) This paragraph shall apply to determine the correct treatment of the items described in subdivision (a) unless the corporation is authorized by its related parties (in the manner and at the time as the Franchise Tax Board shall prescribe) to act as the related parties' limited agent solely for purposes of applying Section 19504 with respect to any request by the Franchise Tax Board to examine records or produce testimony related to any item described in subdivision (a) or with respect to any subpoena or subpoena duces tecum for the records or testimony. The appearance of persons or the production of records by reason of the corporation being an agent shall not subject those persons or records to legal process for any purpose other than determining the correct treatment under Part 11 of the items described in subdivision (a).

(C) Determinations made in the sole discretion of the Franchise Tax Board pursuant to this paragraph may be appealed to the State Board of Equalization, in the

manner and at the time prescribed by Section 19045 or 19324, or may be the subject of an action to recover tax, in the manner and at a time prescribed by Section 19382. The review of determinations by the board or the court shall be limited to whether the determinations were arbitrary or capricious, or are not supported by substantial evidence.

(3) (A) Notwithstanding any other law or rule of law, any reporting corporation to which the Franchise Tax Board issues a subpoena or subpoena duces tecum referred to in subparagraph (A) of paragraph (1) shall have the right to begin a proceeding to quash the subpoena or subpoena duces tecum not later than the 90th day after the subpoena or subpoena duces tecum was issued. In that proceeding, the Franchise Tax Board may seek to compel compliance with the subpoena or subpoena duces tecum.

(B) Notwithstanding any other law or rule of law, any reporting corporation that has been notified by the Franchise Tax Board that it has determined that the corporation has not substantially complied with a subpoena or subpoena duces tecum referred to in paragraph (1) shall have the right to begin a proceeding to review the determination not later than the 90th day after the day on which the notice referred to in subparagraph (C) of paragraph (1) was mailed. If the proceeding is not begun on or before the 90th day, the determination by the Franchise Tax Board shall be binding and shall not be reviewed by any court.

(C) The 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, shall have jurisdiction to hear any proceeding brought under subparagraphs (A) and (B). Any order or other determination in the proceeding shall be treated as a final order that may be appealed.

(D) If any corporation takes any action as provided in subparagraphs (A) and (B), the running of any period of limitations under Sections 19057 to 19064, inclusive (relating to the assessment and collection of tax), or

under Section 19704 (relating to criminal prosecutions) with respect to that corporation shall be suspended for the period during which the proceedings, and appeals therein, are pending. In no event shall any period expire before the 90th day after the day on which there is a final determination in the proceeding.

SEC. 23. Section 19142 of the Revenue and Taxation Code is amended to read:

19142. Except as provided in Sections 19147 and 19148, in the case of any underpayment of tax imposed under Part 11 (commencing with Section 23001) there shall be added to the tax for the ~~income~~ *taxable* year an amount determined at the rate established under Section 19521 on the amount of the underpayment for the period of the underpayment.

SEC. 24. Section 19144 of the Revenue and Taxation Code is amended to read:

19144. For the purposes of Section 19142 the amount of the underpayment shall be the excess of—

(a) (1) The amount of the installment which would be required to be paid if the estimated tax were equal to the applicable percentage of the tax shown on the return for the ~~income~~ *taxable* year, or (2) in the case of the tax imposed by Article 3 (commencing with Section 23181) of Chapter 2 of Part 11 an amount equal to the applicable percentage of the lesser of the tax computed at the rate provided by Section 19024 (but otherwise on the basis of the facts shown on the return and the law applicable to the ~~income~~ *taxable* year), or the tax shown on the return for the ~~income~~ *taxable* year as prescribed by Section 19021, or (3) if no return was filed, the applicable percentage of the tax for that year, over

(b) The amount, if any, of the installment paid on or before the last date prescribed for payment.

(c) For purposes of this section, the ‘‘applicable percentage’’ shall be as follows:

(1) For ~~income~~ *taxable* years beginning before January 1, 1998, 95 percent.

(2) For ~~income~~ *taxable* years beginning on or after January 1, 1998, 100 percent.

SEC. 25. Section 19145 of the Revenue and Taxation Code is amended to read:

19145. For purposes of Section 19142, the period of the underpayment shall run from the date the installment was required to be made to whichever of the following dates is the earlier:

(a) The 15th day of the third month following the close of the ~~income~~ *taxable* year, except in the case of an organization described in Section 23731 subject to the tax imposed under Section 23731, in which case ''fifth'' shall be substituted for ''third.''

(b) With respect to any portion of the underpayment, the date on which that portion is paid. For purposes of this subdivision, a payment of estimated tax on any installment date shall be considered a payment of any previous underpayment only to the extent the payment exceeds the amount of the installment determined under subdivision (a) of Section 19144 for the installment date.

SEC. 26. Section 19147 of the Revenue and Taxation Code is amended to read:

19147. (a) Notwithstanding Sections 19142 to 19145, inclusive, the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax paid on or before the last date prescribed for the payment of the installment equals or exceeds the amount which would have been required to be paid on or before that date if the estimated tax were whichever of the following is the lesser:

(1) (A) The tax shown on the return of the taxpayer for the preceding ~~income~~ *taxable* year if a return showing a liability for tax was filed by the taxpayer for the preceding year and that preceding year was a year of 12 months. The tax shown on the return, in the case of the tax imposed by Article 3 (commencing with Section 23181) of Chapter 2 of Part 11, means the amount of tax shown on the return for the ~~income~~ *taxable* year as prescribed in Section 19021.

(B) In the case of a large corporation, subparagraph (A) shall not apply, except as provided in clauses (i) and (ii).

(i) Subparagraph (A) shall apply for purposes of determining the amount of the first required installment for any ~~income~~ *taxable* year.

(ii) Any reduction in the first required installment by reason of clause (i) shall be recaptured by increasing the amount of the next required installment by the amount of that reduction.

(2) (A) An amount equal to the applicable percentage specified in Section 19144 of the tax for the ~~income~~ *taxable* year computed by placing on an annualized basis the taxable income:

(i) For the first three months of the ~~income~~ *taxable* year, in the case of the installment required to be paid in the fourth month.

(ii) For the first three months of the ~~income~~ *taxable* year, in the case of the installment required to be paid in the sixth month.

(iii) For the first six months of the ~~income~~ *taxable* year in the case of the installment required to be paid in the ninth month.

(iv) For the first nine months of the ~~income~~ *taxable* year, in the case of the installment required to be paid in the 12th month of the taxable year.

(B) (i) If the taxpayer makes an election under this clause, each of the following shall apply:

(I) Clause (i) of subparagraph (A) shall be applied by substituting ‘‘two months’’ for ‘‘three months.’’

(II) Clause (ii) of subparagraph (A) shall be applied by substituting ‘‘four months’’ for ‘‘three months.’’

(III) Clause (iii) of subparagraph (A) shall be applied by substituting ‘‘seven months’’ for ‘‘six months.’’

(IV) Clause (iv) of subparagraph (A) shall be applied by substituting ‘‘ten months’’ for ‘‘nine months.’’

(ii) If the taxpayer makes an election under this clause, each of the following shall apply:

(I) Clause (ii) of subparagraph (A) shall be applied by substituting ‘‘five months’’ for ‘‘three months.’’

(II) Clause (iii) of subparagraph (A) shall be applied by substituting ‘‘eight months’’ for ‘‘six months.’’

(III) Clause (iv) of subparagraph (A) shall be applied by substituting ‘‘eleven months’’ for the ‘‘nine months.’’

(iii) An election under clause (i) or (ii) shall apply to the ~~income~~ *taxable* year for which the election is made and shall be effective only if the election is made on or before the date required for the payment of the first required installment for that ~~income~~ *taxable* year.

(iv) This subparagraph shall apply to income years beginning on or after January 1, 1997.

(C) For purposes of this paragraph, the taxable income shall be placed on an annualized basis in the following manner:

(i) Multiply by 12 the taxable income referred to in subparagraph (A).

(ii) Divide the resulting amount by the number of months in the ~~income~~ *taxable* year referred to in subparagraph (A).

‘‘Taxable income’’ as used in this paragraph means ‘‘net income’’ includable in the measure of tax or ‘‘alternative minimum taxable income’’ (as defined by Section 23455).

(D) In the case of any corporation which is subject to the tax imposed under Section 23731, any reference to taxable income shall be treated as including a reference to unrelated business taxable income and, except in the case of an election under subparagraph (B), each of the following shall apply:

(i) Clause (i) of subparagraph (A) shall be applied by substituting ‘‘two months’’ for ‘‘three months.’’

(ii) Clause (ii) of subparagraph (A) shall be applied by substituting ‘‘four months’’ for ‘‘three months.’’

(iii) Clause (iii) of subparagraph (A) shall be applied by substituting ‘‘seven months’’ for ‘‘six months.’’

(iv) Clause (iv) of subparagraph (A) shall be applied by substituting ‘‘ten months’’ for ‘‘nine months.’’

(3) The applicable percentage specified in Section 19144 or more of the tax for the ~~income~~ *taxable* year was paid by withholding of tax pursuant to Section 18662.

(4) The applicable percentage specified in Section 19144 or more of the net income for the ~~income~~ *taxable* year consists of items from which an amount was withheld pursuant to Section 18662, the amount of the first installment under Section 19025 equals at least the minimum franchise tax specified in Section 23153, and the amount of any installment under Section 19025 includes an amount equal to the applicable tax under Section 23800.5.

(b) (1) For purposes of this section, ''large corporation'' means any corporation if that corporation (or any predecessor corporation) had taxable income (computed without regard to net operating loss deductions) of one million dollars ($1,000,000) or more for any ~~income~~ *taxable* year during the testing period.

(2) For purposes of this subdivision, ''testing period'' means the three ~~income~~ *taxable* years immediately preceding the ~~income~~ *taxable* year involved.

SEC. 27. Section 19148 of the Revenue and Taxation Code is amended to read:

19148. (a) Notwithstanding Sections 19142 to 19147, inclusive, the addition to the tax with respect to any underpayment of any installment shall not be imposed if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of that installment equals or exceeds the applicable percentage specified in Section 19144 of the amount determined under subdivision (b).

(b) The amount determined under this subdivision for any installment shall be determined in the following manner:

(1) Take the net income for all months during the ~~income~~ *taxable* year preceding the filing month.

(2) Divide that amount by the base period percentage for all months during the ~~income~~ *taxable* year preceding the filing month.

(3) Determine the tax on the amount determined under paragraph (2).

(4) Multiply the tax computed under paragraph (3) by the base period percentage for the filing months and all

months during the ~~income~~ *taxable* year preceding the filing month.

(c) For purposes of this subdivision:

(1) The base period percentage for any period of months shall be the average percent which the net income for the corresponding months in each of the three preceding ~~income~~ *taxable* years bears to the net income for the three preceding ~~income~~ *taxable* years.

(2) ''Filing month'' means the month in which the installment is required to be paid.

(3) This subdivision shall only apply if the base period percentage for any six consecutive months of the ~~income~~ *taxable* year equals or exceeds 70 percent.

(4) The Franchise Tax Board may by regulations provide for the determination of the base period percentage in the case of reorganizations, new corporations, and other similar circumstances.

SEC. 28. Section 19150 of the Revenue and Taxation Code is amended to read:

19150. The application of Sections 19142 to 19151, inclusive, to ~~income~~ *taxable* years of less than 12 months shall be in accordance with regulations prescribed by the Franchise Tax Board.

SEC. 29. Section 19164 of the Revenue and Taxation Code is amended to read:

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

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

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

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

(C) For purposes of this section, references in Section 6662(e) of the Internal Revenue Code and the regulations thereunder, relating to treatment of an affiliated group that files a consolidated federal return,

are modified to apply to those entities required to be included in a combined report under Section 25101 or 25110. For these purposes, entities included in a combined report pursuant to paragraph (4) or (6) of subdivision (a) of Section 25110 shall be considered only to the extent required to be included in the combined report.

(b) The modifications to Section 6662 of the Internal Revenue Code by Public Law 103-66 and Public Law 103-465 shall apply with respect to returns filed for ~~income~~ *taxable* years beginning on or after January 1, 1997.

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

(d) The provisions of Section 6664 of the Internal Revenue Code, relating to definitions and special rules, shall apply.

(e) The provisions of Section 6665 of the Internal Revenue Code, relating to applicable rules, shall apply.

SEC. 30. Section 19191 of the Revenue and Taxation Code is amended to read:

19191. (a) The Franchise Tax Board may enter into a voluntary disclosure agreement with any qualified business entity or qualified shareholder, as defined in Section 19192, that is binding on both the Franchise Tax Board and the qualified business entity or qualified shareholder.

(b) The Franchise Tax Board shall do all of the following:

(1) Provide guidelines and establish procedures for business entities to apply for voluntary disclosure agreements.

(2) Accept applications on an anonymous basis from business entities for voluntary disclosure agreements.

(3) Implement procedures for accepting applications for voluntary disclosure agreements through the National Nexus Program administered by the Multistate Tax Commission.

(4) For purposes of considering offers from business entities to enter into voluntary disclosure agreements, take into account the following criteria:

(A) The nature and magnitude of the business entity's previous presence and activity in this state and the facts and circumstances by which the nexus of the business entity was established.

(B) The extent to which the weight of the factual circumstances demonstrates that a prudent business person exercising reasonable care would conclude that the previous activities and presence in this state were or were not immune from taxation by this state by reason of Public Law 86-272 or otherwise.

(C) Reliance on the advice of a person in a fiduciary position or other competent advice that the business entity's activities were immune from taxation by this state.

(D) Lack of evidence of willful disregard or neglect of the tax laws of this state on the part of the business entity.

(E) Demonstrations of good faith on the part of the business entity.

(F) Benefits that will accrue to the state by entering into a voluntary disclosure agreement.

(5) Act on any application of a voluntary disclosure agreement within 120 days of receipt.

(6) Enter into voluntary disclosure agreements with qualified business entities or qualified shareholders, as authorized in subdivision (a) and based on the criteria set forth in paragraph (4).

(c) Before any voluntary disclosure agreement becomes binding, the Franchise Tax Board, itself, shall approve the agreement in the following manner:

(1) The Executive Officer and Chief Counsel of the Franchise Tax Board shall recommend and submit the voluntary disclosure agreement to the Franchise Tax Board for approval.

(2) Each voluntary disclosure agreement recommendation shall be submitted in a manner as to maintain the anonymity of the taxpayer applying for the voluntary disclosure agreement.

(3) Any recommendation for approval of a voluntary disclosure agreement shall be approved or disapproved by the Franchise Tax Board, itself, within 45 days of the submission of that recommendation to the board.

(4) Any recommendation of a voluntary disclosure agreement that is not either approved or disapproved by the board within 45 days of the submission of that recommendation shall be deemed approved.

(5) Disapproval of a recommendation of a voluntary disclosure agreement shall be made only by a majority vote of the Franchise Tax Board.

(6) The members of the Franchise Tax Board shall not participate in any voluntary disclosure agreement except as provided in this subdivision.

(d) The voluntary disclosure agreement entered into by the Franchise Tax Board and the qualified business entity or qualified shareholder as provided for in subdivision (a) shall to the extent applicable specify that:

(1) The Franchise Tax Board shall with respect to a qualified business entity or qualified shareholder, except as provided in paragraph (4) of subdivision (a) of Section 19192:

(A) Waive its authority under this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001) to assess or propose to assess taxes, additions to tax, fees, or penalties with respect to each taxable ~~or income~~ year ending prior to six years from the signing date of the voluntary disclosure agreement.

(B) With respect to each of the six taxable ~~or income~~ years ending immediately preceding the signing date of the voluntary disclosure agreement, based on its discretion, agree to waive any or all of the following:

(i) Any penalty related to a failure to make and file a return, as provided in Section 19131.

(ii) Any penalty related to a failure to pay any amount due by the date prescribed for payment, as provided in Section 19132.

(iii) Any addition to tax related to an underpayment of estimated tax, as provided in Section 19136.

(iv) Any penalty related to Section 6810 or subdivision (a) of Section 8810 of the Corporations Code, as provided in Section 19141.

(v) Any penalty related to a failure to furnish information or maintain records, as provided in Section 19141.5.

(vi) Any addition to tax related to an underpayment of tax imposed under Part 11 (commencing with Section 23001), as provided in Section 19142.

(vii) Any penalty related to a partnership required to file a return under Section 18633, as provided in Section 19172.

(viii) Any penalty related to a failure to file information returns, as provided in Section 19183.

(ix) Any penalty related to relief from contract voidability, as provided in Section 23305.1.

(2) The qualified business entity or qualified shareholder shall:

(A) With respect to each of the six taxable ~~or income~~ years ending immediately preceding the signing date of the written agreement:

(i) Voluntarily and fully disclose on the business entity's application all material facts pertinent to the business entity's and shareholder's liability for any taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(ii) Except as provided in paragraph (3), within 30 days from the signing date of the voluntary disclosure agreement:

(I) File all returns required under this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001).

(II) Pay in full any tax, interest, and penalties (other than those penalties specifically waived by the Franchise Tax Board under the terms of the voluntary disclosure agreement) imposed under this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001) in a manner as may be prescribed by the Franchise Tax Board.

(B) Agree to comply with all franchise and income tax laws of this state in subsequent ~~income or~~ taxable years by filing all returns required and paying all amounts due under this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23001).

(3) The Franchise Tax Board may extend the time for filing returns and paying amounts due to 120 days from the signing date of the voluntary disclosure agreement.

(e) The amendments to this section made by the act adding this subdivision shall apply to taxable ~~or income~~ years beginning on or after January 1, 1997.

SEC. 31. Section 19192 of the Revenue and Taxation Code is amended to read:

19192. For purposes of this article:

(a) (1) ''Qualified business entity'' means an entity that is all of the following:

(A) An entity that is a corporation, as defined in Section 23038.

(B) A business entity, including any predecessors to the business entity, that previously has never filed a return with the Franchise Tax Board pursuant to this part, Part 10 (commencing with Section 17001), or Part 11 (commencing with Section 23011).

(C) A business entity, including any predecessors to the business entity, that previously has not been the subject of an inquiry by the Franchise Tax Board with respect to liability for any of the taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).

(D) A business entity that voluntarily comes forward prior to any unilateral contact from the Franchise Tax Board, makes application for a voluntary disclosure agreement in a form and manner prescribed by the Franchise Tax Board, and makes a full and accurate statement of its activities in this state for the six immediately preceding taxable ~~or income~~ years.

(2) (A) Notwithstanding paragraph (1), a qualified business entity does not include any of the following:

(i) A business entity that is organized and existing under the laws of this state.

(ii) A business entity that is qualified or registered with the office of the Secretary of State.

(iii) A business entity that maintains and staffs a permanent facility in this state.

(B) For purposes of this paragraph, the storing of materials, goods, or products in a public warehouse pursuant to a public warehouse contract does not constitute maintaining a permanent facility in this state.

(3) ''Qualified shareholder'' means an individual that is all of the following:

(A) A nonresident on the signing date of the voluntary disclosure agreement.

(B) A shareholder of an S corporation (defined in Section 23800) that has applied for a voluntary disclosure agreement under this article under which all material facts pertinent to the shareholder's liability would be disclosed on that S corporation's voluntary disclosure agreement as required under clause (i) of subparagraph (A) of paragraph (2) of subdivision (d) of Section 19191.

(4) Notwithstanding paragraph (3), subparagraph (B) of paragraph (1) of subdivision (d) of Section 19191 shall not apply to any of the six taxable years immediately preceding the signing date that the qualified shareholder was a California resident required to file a California tax return, nor to any penalties or additions to tax attributable to income other than the California source income from the S corporation that filed an application under this article.

(b) ''Signing date'' of the voluntary disclosure agreement means the date on which a person duly authorized by the Franchise Tax Board signs the agreement.

(c) The amendments to this section made by the act adding this subdivision shall apply to taxable ~~or income~~ years beginning on or after January 1, 1997.

SEC. 32. Section 19193 of the Revenue and Taxation Code is amended to read:

19193. Nothing in this article shall be construed to mean that by accepting and signing a voluntary disclosure agreement the Franchise Tax Board abdicates

the right and authority to examine returns and determine the correct amount of tax for any of the taxable ~~or income~~ years covered by the voluntary disclosure period agreed upon and to assess any additional tax, penalty, or interest owed as a result of that examination.

SEC. 33. Section 19194 of the Revenue and Taxation Code is amended to read:

19194. (a) Notwithstanding any other provision of this article, a voluntary disclosure agreement shall be null and void in the event that the Franchise Tax Board finds that with respect to the agreement any of the following circumstances exist:

(1) The qualified business entity has misrepresented any material fact in applying for the voluntary disclosure agreement or in entering into the agreement.

(2) The qualified business entity fails to file any returns for any taxable ~~or income~~ year covered by the voluntary disclosure period agreed upon on or before the due date prescribed under the terms of the agreement in accordance with paragraph (2) of subdivision (d) of Section 19191.

(3) (A) The qualified business entity fails to pay in full any tax, penalty, or interest due within the time prescribed under the terms of the voluntary disclosure agreement in accordance with paragraph (2) of subdivision (d) of Section 19191 or to pay any installments thereof due within the time prescribed under the terms of an installment payment arrangement in accordance with subparagraph (B).

(B) The Franchise Tax Board may enter into an installment payment arrangement, which shall include provisions for interest, in lieu of the full payment required under paragraph (2) of subdivision (d) of Section 19191. Failure by the qualified business entity to comply with the terms of the installment payment arrangement shall also render the voluntary disclosure arrangement null and void.

(4) The tax shown by the qualified business entity on its tax return filed for any taxable ~~or income~~ year covered by the voluntary disclosure agreement, including any

amount shown on a qualified amended return, as defined in Section 1.6664-2(c)(3) of Title 26 of the Code of Federal Regulations, understates by 10 percent or more the tax imposed under either Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001) and the qualified business cannot demonstrate to the satisfaction of the Franchise Tax Board that a good-faith effort was made to accurately compute the tax.

(5) The qualified taxpayer fails to begin to prospectively comply with all franchise and income tax laws of this state as agreed upon under the terms of the voluntary disclosure agreement in accordance with paragraph (2) of subdivision (d) of Section 19191.

(b) In the event that the Franchise Tax Board finds that the qualified business entity has failed to comply under any of the circumstances which render the voluntary disclosure agreement null and void as set forth in subdivision (a), the limitation on assessment for any taxable ~~or income~~ years and the waiver of any penalties as provided for in paragraph (1) of subdivision (d) of Section 19191 shall not be binding on the Franchise Tax Board.

SEC. 34. Section 19363 of the Revenue and Taxation Code is amended to read:

19363. Credits or refunds of overpayments of estimated tax shall be made by the Franchise Tax Board as provided in this article. Any amount paid as estimated tax for any taxable year shall be deemed to have been paid on the last day prescribed for filing the return for the ~~income or~~ taxable year (determined without regard to any extension of time for filing the return).

SEC. 35. Section 19364 of the Revenue and Taxation Code is amended to read:

19364. If any overpayment of tax is claimed as a credit against estimated tax for the succeeding taxable ~~or income~~ year, that amount shall be considered as payment of the tax for the succeeding year (whether or not claimed as a credit in the return of estimated tax for that succeeding year), and no claim for credit or refund of that

overpayment shall be allowed for the ~~income or~~ taxable year in which the overpayment arises.

SEC. 36. Section 19365 of the Revenue and Taxation Code is amended to read:

19365. (a) (1) A corporation electing to be treated as an "S corporation" under Chapter 4.5 (commencing with Section 23800) of Part 11 may file an application for the transfer of an overpayment with respect to payments of estimated tax for ~~income~~ *taxable* years beginning in 1997 to the personal income tax accounts of its shareholders. An application under this subdivision shall not constitute a claim for credit or refund.

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

(A) The amount the "S corporation" estimates as its tax liability under this part for the taxable year, which shall not be less than the greater of $1^1/_2$ percent of its net income or the applicable minimum franchise tax.

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

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

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

(b) (1) Within a period of 45 days from the date on which an application for a transfer is filed under subdivision (a), the Franchise Tax Board shall make, to the extent it deems practicable in that period, a limited examination of the application to discover omissions and errors therein, and shall determine the final amount of the transfers upon the basis of the application and the examination, except that the Franchise Tax Board may

disallow, without further action, any application which it finds contains material omissions or errors which it deems cannot be corrected within the 45-day period.

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

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

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

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

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

SEC. 37. Section 19503 of the Revenue and Taxation Code is amended to read:

19503. (a) The Franchise Tax Board shall prescribe all rules and regulations necessary for the enforcement of Part 10 (commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), and this part and may prescribe the extent to which any ruling (including any judicial decision or any administrative determination other than by regulation) shall be applied without retroactive effect.

(b) (1) Except as otherwise provided in this subdivision, no regulation relating to Part 10

(commencing with Section 17001), Part 10.7 (commencing with Section 21001), Part 11 (commencing with Section 23001), or this part shall apply to any taxable ~~or income~~ year ending before the date on which any notice substantially describing the expected contents of any regulation is issued to the public.

(2) Paragraph (1) shall not apply to either of the following:

(A) Regulations issued within 24 months of the date of the enactment of the statutory provision to which the regulation relates.

(B) Regulations issued within 24 months of the date that temporary or final federal regulations with respect to statutory provisions to which California conforms are filed with the Federal Register.

(3) The Franchise Tax Board may provide that any regulation may take effect or apply retroactively to prevent abuse.

(4) The Franchise Tax Board may provide that any regulation may apply retroactively to correct a procedural defect in the issuance of any prior regulation.

(5) The limitation of paragraph (1) shall not apply to any regulation relating to the Franchise Tax Board's policies, practices, or procedures.

(6) The limitation of paragraph (1) may be superseded by a legislative grant of authority to the Franchise Tax Board to prescribe the effective date with respect to any regulation.

(7) The Franchise Tax Board may provide for any taxpayer to elect to apply any regulation before the dates specified in paragraph (1).

(c) The amendments made by the act adding this subdivision are operative with respect to regulations which relate to California statutory provisions enacted on or after January 1, 1998.

SEC. 38. Section 19565 of the Revenue and Taxation Code is amended to read:

19565. (a) If an organization is exempt from taxation under Section 23701 for any ~~income~~ *taxable* year, the application filed by the organization with respect to

which the Franchise Tax Board made its determination that the organization was entitled to exemption under Section 23701, together with any papers submitted in support of the application, and any letter or other document issued by the Franchise Tax Board, with respect to the application, shall be open to public inspection. Any inspection under this subdivision may be made at the times, and in the manner, as the Franchise Tax Board shall by regulations prescribe. After the application of any organization has been opened to public inspection under this subdivision, the Franchise Tax Board shall, on the request of any person with respect to the organization, furnish a statement indicating the section which it has been determined describes the organization.

(b) Upon request of the organization submitting any supporting papers described in subdivision (a), the Franchise Tax Board shall withhold from public inspection any information contained therein which it determines relates to any trade secret, patent, process, style of work, or apparatus, of the organization, if it determines that public disclosure of the information would adversely affect the organization. The Franchise Tax Board shall withhold from public inspection any information contained in supporting papers described in subdivision (a) the public disclosure of which it determines would adversely affect the national defense.

(c) The Franchise Tax Board may impose a reasonable charge for supplying any information the disclosure of which is permitted under this section.

SEC. 39. Section 21026 of the Revenue and Taxation Code is amended to read:

21026. (a) Except as otherwise provided in subdivision (b), for ~~income or~~ taxable years beginning on or after January 1, 1998, the board shall, not less than annually, mail a written notice to each taxpayer who has a tax delinquent account of the amount of the tax delinquency as of the date of the notice.

(b) Subdivision (a) shall not apply to accounts where a previously mailed notice to the address of record was

returned to the board as undeliverable, or to accounts that are discharged from accountability pursuant to Chapter 3 (commencing with Section 13940) of Part 4 of Division 3 of Title 2 of the Government Code.

SEC. 40. Section 23036 of the Revenue and Taxation Code is amended to read:

23036. (a) (1) The term ‘‘tax’’ includes any of the following:

(A) The tax imposed under Chapter 2 (commencing with Section 23101).

(B) The tax imposed under Chapter 3 (commencing with Section 23501).

(C) The tax on unrelated business taxable income, imposed under Section 23731.

(D) The tax on S corporations imposed under Section 23802.

(2) The term ‘‘tax’’ does not include any amount imposed under paragraph (1) of subdivision (e) of Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

(b) For purposes of Article 5 (commencing with Section 18661) of Chapter 2, Article 3 (commencing with Section 19031) of Chapter 4, Article 6 (commencing with Section 19101) of Chapter 4, and Chapter 7 (commencing with Section 19501) of Part 10.2, and for purposes of Sections 18601, 19001, and 19005, the term ‘‘tax’’ shall also include all of the following:

(1) The tax on limited partnerships, imposed under Section 17935 or Section 23081, the tax on limited liability companies, imposed under Section 17941 or Section 23091, and the tax on registered limited liability partnerships and foreign limited liability partnerships imposed under Section 17948 or Section 23097.

(2) The alternative minimum tax imposed under Chapter 2.5 (commencing with Section 23400).

(3) The tax on built-in gains of S corporations, imposed under Section 23809.

(4) The tax on excess passive investment income of S corporations, imposed under Section 23811.

(c) Notwithstanding any other provision of this part, credits shall be allowed against the ‘‘tax’’ in the following order:

(1) Credits that do not contain carryover provisions.

(2) Credits that, when the credit exceeds the ‘‘tax,’’ allow the excess to be carried over to offset the ‘‘tax’’ in succeeding taxable years. The order of credits within this paragraph shall be determined by the Franchise Tax Board.

(3) The minimum tax credit allowed by Section 23453.

(4) Credits for taxes withheld under Section 18662.

(d) Notwithstanding any other provision of this part, each of the following shall be applicable:

(1) No credit shall reduce the ‘‘tax’’ below the tentative minimum tax (as defined by paragraph (1) of subdivision (a) of Section 23455), except the following credits, but only after allowance of the credit allowed by Section 23453:

(A) The credit allowed by former Section 23601 (relating to solar energy).

(B) The credit allowed by former Section 23601.4 (relating to solar energy).

(C) The credit allowed by Section 23601.5 (relating to solar energy).

(D) The credit allowed by Section 23609 (relating to research expenditures).

(E) The credit allowed by Section 23609.5 (relating to clinical testing expenses).

(F) The credit allowed by Section 23610.5 (relating to low-income housing).

(G) The credit allowed by former Section 23612 (relating to sales and use tax credit).

(H) The credit allowed by Section 23612.2 (relating to enterprise zone sales or use tax credit).

(I) The credit allowed by Section 23612.6 (relating to Los Angeles Revitalization Zone sales tax credit).

(J) The credit allowed by former Section 23622 (relating to enterprise zone hiring credit).

(K) The credit allowed by Section 23622.7 (relating to enterprise zone hiring credit).

(L) The credit allowed by former Section 23623 (relating to program area hiring credit).

(M) For each ~~income~~ *taxable* year beginning on or after January 1, 1994, the credit allowed by Section 23623.5 (relating to Los Angeles Revitalization Zone hiring credit).

(N) The credit allowed by Section 23625 (relating to Los Angeles Revitalization Zone hiring credit).

(O) The credit allowed by Section 23633 (relating to targeted tax area sales or use tax credit).

(P) The credit allowed by Section 23634 (relating to targeted tax area hiring credit).

(Q) The credit allowed by Section 23649 (relating to qualified property).

(2) No credit against the tax shall reduce the minimum franchise tax imposed under Chapter 2 (commencing with Section 23101).

(e) Any credit which is partially or totally denied under subdivision (d) shall be allowed to be carried over to reduce the ''tax'' in the following year, and succeeding years if necessary, if the provisions relating to that credit include a provision to allow a carryover of the unused portion of that credit.

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

(g) Unless otherwise provided, if two or more taxpayers share in costs that would be eligible for a tax credit allowed under this part, each taxpayer shall be eligible to receive the tax credit in proportion to its respective share of the costs paid or incurred.

(h) Unless otherwise provided, in the case of an S corporation, any credit allowed by this part shall be computed at the S corporation level, and any limitation on the expenses qualifying for the credit or limitation upon the amount of the credit shall be applied to the S corporation and to each shareholder.

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

(2) The amount of any credit otherwise allowed under this part, including any credit carryover from prior years, that may be applied to reduce the taxpayer's ''tax,'' as defined in subdivision (a), for the ~~income~~ *taxable* year shall be limited to an amount equal to the excess of the taxpayer's regular tax (as defined in Section 23455), determined by including income attributable to the disregarded business entity that generated the credit or credit carryover, over the taxpayer's regular tax (as defined in Section 23455), determined by excluding the income attributable to that disregarded business entity. No credit shall be allowed if the taxpayer's regular tax (as defined in Section 23455), determined by including the income attributable to the disregarded business entity is less than the taxpayer's regular tax (as defined in Section 23455), determined by excluding the income attributable to the disregarded business entity.

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

SEC. 41. Section 23041 of the Revenue and Taxation Code is amended to read:

23041. ''Taxable year'' means:

(a) For *calendar or fiscal years beginning before January 1, 2000,* the purposes of the tax imposed under Chapter 2 (commencing with Section 23101), the calendar year, or the fiscal year for which the tax is payable.

(b) For the purposes of the tax imposed under Chapter 1.5 (commencing with Section 23081), Chapter

3 (commencing with Section 23501), or Chapter 4 (commencing with Section 23701), the calendar year or the fiscal year upon the basis of which the net income is computed.

(c) For purposes of the tax imposed under Chapter 2.5 (commencing with Section 23400), (1) in the case of a taxpayer subject to the tax imposed under Chapter 2 (commencing with Section 23101), the calendar year or the fiscal year for which the tax is payable and (2) in the case of a taxpayer subject to the tax imposed under Chapter 3 (commencing with Section 23501) or Chapter 4 (commencing with Section 23701), the calendar or fiscal year upon the basis of which the net income is computed.

(d) For the purpose of the taxes imposed under this part, a period of 12 months or less.

(e) When referring to a calendar or fiscal year beginning before January 1, 2000, upon the basis of which the net income is computed, the term "taxable year" shall mean "income year," as defined in subdivision (a) of Section 23042.

SEC. 42. Section 23042 of the Revenue and Taxation Code is amended to read:

23042. ~~"Income~~ *(a) For taxable years beginning prior to January 1, 2000, and the first taxable year beginning on or after January 1, 2000, "income* year'' means:

~~(a)~~

(1) For the purposes of the tax imposed under Chapter 2 (commencing with Section 23101), the calendar year or the fiscal year upon the basis of which the net income is computed. ''Income year'' means, for the purposes of the tax imposed under Chapter 2 (commencing with Section 23101), in the case of a return made for a fractional part of a year, the period for which such return is made.

~~(b)~~

(2) For the purposes of the tax imposed under Chapter 1.5 (commencing with Section 23081), Chapter 3 (commencing with Section 23501), or Chapter 4 (commencing with Section 23701), wherever ''income year'' is used throughout this part, it means ''taxable year''

as that term is defined in Section 23041 for the purposes of the tax imposed under Chapter 1.5 (commencing with Section 23081), Chapter 3 (commencing with Section 23501), or Chapter 4 (commencing with Section 23701).

~~(c)~~

(3) For purposes of the tax imposed under Chapter 2.5 (commencing with Section 23400), the same as defined in subdivision (a) with respect to a taxpayer subject to the tax imposed under Chapter 2 (commencing with Section 23101) and the same as defined in subdivision (b) with respect to a taxpayer subject to the tax imposed under Chapter 3 (commencing with Section 23501) or Chapter 4 (commencing with Section 23701).

(b) For taxable years (other than the first taxable year) beginning on or after January 1, 2000, the term "income year" shall have the same meaning as the term "taxable year" (as defined by Section 23041).

SEC. 43. Section 23051.5 of the Revenue and Taxation Code is amended to read:

23051.5. (a) (1) Unless otherwise specifically provided, the terms ''Internal Revenue Code,'' ''Internal Revenue Code of 1954,'' or ''Internal Revenue Code of 1986,'' for purposes of this part, mean Title 26 of the United States Code, including all amendments thereto, as enacted on the specified date for the applicable taxable year as defined in paragraph (1) of subdivision (a) of Section ~~17024.5, except that for purposes of this part, ''income year'' shall be substituted for ''taxable year'' throughout that section~~ *17024.5*.

(2) Unless otherwise specifically provided, for federal laws enacted on or after January 1, 1987, and on or before the specified date for the ~~income~~ *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 ~~income~~ *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 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) Domestic International Sales Corporations (DISC), as defined in Section 992(a) of the Internal Revenue Code.

(2) Foreign Sales Corporations (FSC), as defined in Section 922(a) of the Internal Revenue Code.

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

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

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

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

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

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

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

(3) For ~~income~~ *taxable* years beginning on and after January 1, 1987, the provisions referred to by paragraphs

(1) and (2) shall be applicable for purposes of this part in the same manner and with respect to the same obligations as the federal provisions, except as otherwise provided in this part.

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

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

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

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

(3) To obtain treatment other than that elected for federal purposes, a separate election shall be filed with the Franchise Tax Board at the time and in the manner which may be 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 apply to that application or consent.

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

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

(1) For purposes of Chapter 2 (commencing with Section 23101), Chapter 2.5 (commencing with Section 23400), and Chapter 3 (commencing with Section 23501), the term ''taxable income'' shall mean ''net income.''

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

(3) Any reference to ‘‘subtitle,’’ ‘‘Chapter 1,’’ or ‘‘chapter’’ shall mean this part.

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

(5) Any provision of the Internal Revenue Code that becomes operative on or after the specified date for that ~~income~~ *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 ~~income~~ *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 ‘‘income year’’ for ‘‘taxable year’’ when appropriate,~~ substitution of ‘‘Franchise Tax Board’’ for ‘‘secretary’’ when appropriate, and other obvious differences.

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

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

SEC. 44. Section 23058 of the Revenue and Taxation Code is amended to read:

23058. Unless otherwise specifically provided therein, the provisions of any act:

(a) That affect the imposition or computation of tax, penalties, or the allowance of credits against the tax, shall be applied to ~~income~~ *taxable* years beginning on or after January 1 of the year in which the act takes effect.

(b) That otherwise affect the provisions of this part shall be applied on and after the date the act takes effect.

SEC. 45. Section 23104 of the Revenue and Taxation Code is amended to read:

23104. (a) For purposes of this part only, any corporation that is not incorporated under the laws of this state and whose sole activity in this state is engaging in convention and trade show activities, as described in Section 513(d)(3)(A) of the Internal Revenue Code, for seven or fewer calendar days, or any portion thereof, during the ~~income~~ *taxable* year and that does not derive more than ten thousand dollars ($10,000) of gross income reportable to this state from those activities during that ~~income~~ *taxable* year is not a corporation doing business in this state.

(b) For purposes of this section, the determination of gross income reportable to this state of a taxpayer shall be made by including the gross income reportable to this state of each member of the ‘‘commonly controlled group’’ (as defined by Section 25105) of which the taxpayer is a member.

SEC. 46. Section 23114 of the Revenue and Taxation Code is amended to read:

23114. A corporation shall not be subject to the taxes imposed by this chapter if the corporation did no business in this state during the ~~income~~ *taxable* year and the ~~income~~ *taxable* year was 15 days or less.

SEC. 47. Section 23151 of the Revenue and Taxation Code is amended to read:

23151. (a) With the exception of banks and financial corporations, every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income, to be computed at the rate of 7.6 percent upon the basis of its net income for the next preceding income year, or if greater, the minimum tax specified in Section 23153.

(b) For calendar or fiscal years ending after June 30, 1973, the rate of tax shall be 9 percent instead of 7.6 percent as provided by subdivision (a).

(c) For calendar or fiscal years ending in 1980 to 1986, inclusive, the rate of tax shall be 9.6 percent.

(d) For calendar or fiscal years ending in 1987 to 1996, inclusive, and for any income year beginning before January 1, 1997, the tax rate shall be 9.3 percent.

(e) For any income year beginning on or after January 1, 1997, the tax rate shall be 8.84 percent. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

(f) (1) For the first taxable year beginning on or after January 1, 2000, the tax imposed under this section shall be the sum of both of the following:

(A) A tax according to or measured by net income, to be computed at the rate of 8.84 percent upon the basis of the net income for the next preceding income year, but not less than the minimum tax specified in Section 23153.

(B) A tax according to or measured by net income, to be computed at the rate of 8.84 percent upon the basis of the net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum tax specified in Section 23153.

(2) Except as provided in paragraph (1), for taxable years beginning on or after January 1, 2000, the tax imposed under this section shall be a tax according to or measured by net income, to be computed at the rate of 8.84 percent upon the basis of the net income for that taxable year, but not less than the minimum tax specified in Section 23153.

SEC. 48. Section 23151.1 of the Revenue and Taxation Code is amended to read:

23151.1. Notwithstanding Section 23151, every corporation (except banks and financial corporations) doing business within the limits of this state and not exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state for the privilege of exercising its corporate franchises within this state, a tax determined as follows:

(a) With respect to corporations, other than those described in subdivision (b), which commence doing business within the state after December 31, 1971, *and*

before January 1, 2000, the tax for the taxable year of commencement, whether or not for 12 full months, shall be the minimum franchise tax prescribed in Section 23153.

(b) If after December 31, 1972, a corporation commences to do business and ceases doing business in the same taxable year, the tax for that taxable year shall be according to or measured by its net income for the year, to be computed at the rate prescribed in Section 23151.

(c) *(1)* With respect to taxable years beginning after December 31, 1972, *and before January 1, 2000,* other than the year of commencement described in subdivision (a) or (b) or the year of cessation described in subdivision (d), the tax for that taxable year shall be according to or measured by its net income for the next preceding ~~income~~ *taxable* year, to be computed at the rate prescribed in Section 23151.

(2) With respect to taxable years beginning on or after January 1, 2000, (other than the first taxable year beginning on or after that date), the tax for the taxable year (including the taxable year of commencement and the taxable year of cessation) shall be according to or measured by its net income for the taxable year to be computed at the rate prescribed in Section 23151.

(d) With respect to corporations which cease doing business in a taxable year beginning after December 31, 1972, *and before January 1, 2000,* other than those described in subdivision (b), the tax for the taxable year of cessation shall be:

(1) According to or measured by its net income for the next preceding ~~income~~ *taxable* year, to be computed at the rate prescribed in Section 23151, plus

(2) According to or measured by its net income for the ~~income~~ *taxable* year during which the corporation ceased doing business, to be computed at the rate prescribed in Section 23151.

(e) In any event, the tax for any taxable year shall not be less than the minimum tax provided for in Section 23153 for that taxable year.

SEC. 49. Section 23151.2 of the Revenue and Taxation Code is amended to read:

23151.2. Notwithstanding Section 23151, every corporation (except banks and financial corporations) not exempted from taxation by the provisions of the Constitution of this state or by this part which dissolves or withdraws, shall pay a tax for its taxable year of dissolution or withdrawal according to or measured by its net income for the ~~income~~ *taxable* year in which it ceased doing business, unless that income has previously been included in the measure of tax for any taxable year, to be computed at the rate prescribed in Section 23151 for its taxable year of dissolution or withdrawal. In any event, the tax for the taxable year of its dissolution or withdrawal shall not be less than the minimum tax provided for in Section 23153 for that taxable year.

SEC. 50. Section 23153 of the Revenue and Taxation Code is amended to read:

23153. (a) Every corporation described in subdivision (b) shall be subject to the minimum franchise tax specified in subdivision (d) from the earlier of the date of incorporation, qualification, or commencing to do business within 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 within the limits of this state.

(b) Unless expressly exempted by this part or the California Constitution, subdivision (a) shall apply to each of the following:

(1) Every corporation that is incorporated under the laws of this state.

(2) Every corporation that is 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.

(3) Every corporation that is doing business in this state.

(c) The following entities are not subject to the minimum franchise tax specified in this section:

(1) Credit unions.

(2) Nonprofit cooperative associations organized pursuant to Chapter 1 (commencing with Section 54001) of Division 20 of the Food and Agricultural Code that have been issued the certificate of the board of supervisors prepared pursuant to Section 54042 of the Food and Agricultural Code. The association shall be exempt from the minimum franchise tax for five consecutive ~~income~~ *taxable* years, commencing with the first ~~income~~ *taxable* year for which the certificate is issued pursuant to subdivision (b) of Section 54042 of the Food and Agricultural Code. This paragraph only applies to nonprofit cooperative associations organized on or after January 1, 1994.

(d) (1) Except as provided in paragraph (2), *paragraph (1) of subdivision (f) of Section 23151, paragraph (1) of subdivision (f) of Section 23181, and paragraph (1) of subdivision (c) of Section 23183,* corporations subject to the minimum franchise tax shall pay annually to the state a minimum franchise tax of eight hundred dollars ($800).

(2) The minimum franchise tax shall be twenty-five dollars ($25) for each of the following:

(A) A corporation formed under the laws of this state whose principal business when formed was gold mining, which is inactive and has not done business within the limits of the state since 1950.

(B) A corporation formed under the laws of this state whose principal business when formed was quicksilver mining, which is inactive and has not done business within the limits of the state since 1971, or has been inactive for a period of 24 consecutive months or more.

(3) For purposes of paragraph (2), a corporation shall not be considered to have done business if it engages in other than mining.

(e) Notwithstanding subdivision (a), for ~~income~~ *taxable* years beginning on or after January 1, 1999, and before January 1, 2000, every ‘‘qualified new corporation’’ shall pay annually to the state a minimum franchise tax of five hundred dollars ($500) for the second taxable year. This subdivision shall apply to any corporation that is a

qualified new corporation and is incorporated on or after January 1, 1999, and before January 1, 2000.

(1) The determination of the gross receipts of a corporation, for purposes of this subdivision, shall be made by including the gross receipts of each member of the commonly controlled group, as defined in Section 25105, of which the corporation is a member.

(2) ''Gross receipts, less returns and allowances reportable to this state,'' 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.

(3) ''Qualified new corporation'' means a corporation that is incorporated under the laws of this state or has qualified to transact intrastate business in this state, that begins business operations at or after the time of its incorporation and that reasonably estimates that it will have gross receipts, less returns and allowances, reportable to this state for the ~~income~~ *taxable* year of one million dollars ($1,000,000) or less. ''Qualified new corporation'' does not include any corporation that began business operations as a sole proprietorship, a partnership, or any other form of business entity prior to its incorporation. This subdivision shall not apply to any corporation that reorganizes solely for the purpose of reducing its minimum franchise tax.

(4) This subdivision shall not apply to limited partnerships, as defined in Section 17935, limited liability companies, as defined in Section 17941, limited liability partnerships, as defined in Section 17948, charitable organizations, as described in Section 23703, regulated investment companies, as defined in Section 851 of the Internal Revenue Code, real estate investment trusts, as defined in Section 856 of the Internal Revenue Code, real estate mortgage investment conduits, as defined in Section 860D of the Internal Revenue Code, financial asset securitization investment trusts, as defined in Section 860L of the Internal Revenue Code, qualified Subchapter S subsidiaries, as defined in Section

1361(b)(3) of the Internal Revenue Code, or to the formation of any subsidiary corporation, to the extent applicable.

(5) For any ~~income~~ *taxable* year beginning on or after January 1, 1999, and before January 1, 2000, if a corporation has qualified to pay five hundred dollars ($500) for the second taxable year under this subdivision, but in its second taxable year, the corporation's gross receipts, as determined under paragraphs (1) and (2), exceed one million dollars ($1,000,000), an additional tax in the amount equal to three hundred dollars ($300) for the second taxable year shall be due and payable by the corporation on the due date of its return, without regard to extension, for that year.

(f) (1) Notwithstanding subdivision (a), every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, shall not be subject to the minimum franchise tax for its first ~~and second~~ taxable ~~years~~ *year*.

(2) This subdivision shall not apply to limited partnerships, as defined in Section 17935, limited liability companies, as defined in Section 17941, limited liability partnerships, as defined in Section 17948, charitable organizations, as described in Section 23703, regulated investment companies, as defined in Section 851 of the Internal Revenue Code, real estate investment trusts, as defined in Section 856 of the Internal Revenue Code, real estate mortgage investment conduits, as defined in Section 860D of the Internal Revenue Code, financial asset securitization investment trusts, as defined in Section 860L of the Internal Revenue Code, and qualified Subchapter S subsidiaries, as defined in Section 1361(b)(3) of the Internal Revenue Code, to the extent applicable.

(3) This subdivision shall not apply to any corporation that reorganizes solely for the purpose of avoiding payment of its minimum franchise tax.

(g) Notwithstanding subdivision (a), a domestic corporation, as defined in Section 167 of the Corporations Code, that files a certificate of dissolution in the office of

the Secretary of State pursuant to subdivision (c) of Section 1905 of the Corporations Code and that does not thereafter do business shall not be subject to the minimum franchise tax for ~~income~~ *taxable* years beginning on or after the date of that filing.

(h) The minimum franchise tax imposed by paragraph (1) of subdivision (d) shall not be increased by the Legislature by more than 10 percent during any calendar year.

SEC. 51. Section 23181 of the Revenue and Taxation Code is amended to read:

23181. (a) Except as otherwise provided herein, an annual tax is hereby imposed upon every bank doing business within the limits of this state according to or measured by its net income, upon the basis of its net income for the next preceding income year at the rate provided under Section 23186.

(b) If a bank commences to do business and ceases doing business in the same taxable year, the tax for such taxable year shall be according to or measured by its net income for such year, at the rate provided under Section 23186.

(c) With respect to a bank, other than a bank described in subdivision (b), which ceases doing business after December 31, 1972, the tax for the taxable year of cessation shall be:

(1) According to or measured by its net income for the next preceding income year, to be computed at the rate prescribed in Section 23186, plus

(2) According to or measured by its net income for the income year during which the bank ceased doing business, to be computed at the rate prescribed in Section 23186.

(d) In the case of a bank which ceased doing business before January 1, 1973, but dissolves or withdraws on such date or thereafter, the tax for the taxable year of dissolution or withdrawal shall be according to or measured by its net income for the income year during which the bank ceased doing business, unless such income has previously been included in the measure of tax for any

taxable year, to be computed at the rate prescribed under Section 23186 for the taxable year of dissolution or withdrawal.

(e) Commencing with income years ending in 1980, every bank shall pay to the state a minimum tax (determined in accordance with Section 23153) or the measured tax imposed on its income, whichever is greater.

(f) (1) For the first taxable year beginning on or after January 1, 2000, the tax imposed under this section shall be the sum of both of the following:

(A) A tax according to or measured by net income, to be computed at the rate provided under Section 23186 upon the basis of the net income for the next preceding income year, but not less than the minimum tax specified in Section 23153.

(B) A tax according to or measured by net income, to be computed at the rate provided under Section 23186 upon the basis of the net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum tax specified in Section 23153.

(2) Except as provided in paragraph (1), for taxable years beginning on or after January 1, 2000, the tax imposed under this section shall be a tax according to or measured by net income, to be computed at the rate provided under Section 23186 upon the basis of the net income for that taxable year, but not less than the minimum tax specified in Section 23153.

SEC. 52. Section 23183 of the Revenue and Taxation Code is amended to read:

23183. (a) ~~An~~ *For taxable years beginning before January 1, 2000, an* annual tax is hereby imposed upon every financial corporation doing business within the limits of this state and taxable under the provisions of Section 27 of Article XIII of the Constitution of this state, for the privilege of exercising its corporate franchises within this state, according to or measured by its net income, upon the basis of its net income for the next preceding income year at the rate provided under Section 23186.

(b) For purposes of this article, the term ''financial corporation'' does not include any corporation, including a wholly owned subsidiary of a bank or bank holding company, if the principal business activity of such entity consists of leasing tangible personal property.

(c) (1) For the first taxable year beginning on or after January 1, 2000, the tax imposed under this section shall be the sum of both of the following:

(A) A tax according to or measured by net income, to be computed at the rate provided under Section 23186 upon the basis of the net income for the next preceding income year, but not less than the minimum tax specified in Section 23153.

(B) A tax according to or measured by net income, to be computed at the rate provided under Section 23186 upon the basis of the net income for the first taxable year beginning on or after January 1, 2000, but not less than the minimum tax specified in Section 23153.

(2) Except as provided in paragraph (1), for taxable years beginning on or after January 1, 2000, the tax imposed under this section shall be a tax according to or measured by net income, to be computed at the rate provided under Section 23186 upon the basis of the net income for that taxable year, but not less than the minimum tax specified in Section 23153.

SEC. 53. Section 23183.1 of the Revenue and Taxation Code is amended to read:

23183.1. Notwithstanding Section 23183, every financial corporation doing business within the limits of this state and not exempted from taxation by the Constitution of this state or by this part, shall annually pay to the state for the privilege of exercising its corporate franchises within this state, a tax determined as follows:

(a) If a financial corporation commences to do business and ceases doing business in the same taxable year, the tax for that taxable year shall be according to or measured by its net income for that year, at the rate provided under Section 23186.

(b) *(1)* With respect to taxable years *beginning before January 1, 2000,* other than the year of

commencement described in subdivision (a) or the year of cessation described in subdivision (c), a tax according to or measured by its net income, to be computed at the rate prescribed in Section 23186 upon the basis of its net income for the next preceding income year.

(2) With respect to taxable years beginning on or after January 1, 2000 (other than the first taxable year beginning on or after that date), the tax for the taxable year (including the taxable year of commencement and the taxable year of cessation) shall be a tax according to or measured by its net income, to be computed at the rate prescribed in Section 23186 upon the basis of its net income for the taxable year.

(c) With respect to financial corporations, which cease doing business in a taxable year *beginning before January 1, 2000,* other than those described in subdivision (a), the tax for the taxable year of cessation shall be:

(1) According to or measured by its net income for the next preceding income year to be computed at the rate prescribed in Section 23186, plus

(2) According to or measured by its net income for the income year during which the financial corporation ceased doing business, to be computed at the rate prescribed in Section 23186.

SEC. 54. Section 23183.2 of the Revenue and Taxation Code is amended to read:

23183.2. Notwithstanding Section 23183, every financial corporation not exempted from taxation by the provisions of the Constitution of this state or by this part which dissolves or withdraws, shall pay a tax for its taxable year of dissolution or withdrawal according to or measured by its net income for the ~~income~~ *taxable* year in which it ceased doing business, to be computed at the rate prescribed in Section 23186 for its taxable year of dissolution or withdrawal, unless the income has previously been included in the measure of tax for any taxable year.

SEC. 55. Section 23186 of the Revenue and Taxation Code is amended to read:

23186. For ~~income~~ *taxable* years ending on or after December 31, 1995, the rate of tax on banks and financial corporations shall be the rate of tax specified in Section 23151, plus 2 percent.

SEC. 56. Section 23253 of the Revenue and Taxation Code is amended to read:

23253. Section 381(b) of the Internal Revenue Code, relating to operating rules, shall apply in determining the close of the ~~income~~ *taxable* year. If a short period year is required by use of Section 381(b) of the Internal Revenue Code, the transferor's short year tax shall be computed using the provisions of Section 23151.1 for general corporations or Section 23181 for banks and financial corporations.

SEC. 57. Section 23281 of the Revenue and Taxation Code is amended to read:

23281. (a) *(1)* When a taxpayer ceases to do business within the state during any taxable year and does not dissolve or withdraw from the state during that year, and does not resume doing business during the succeeding taxable year, its tax for the taxable year in which it resumes doing business *prior to January 1, 2000,* shall be the greater of the following:

~~(1)~~

(A) The tax computed upon the basis of the net income of the income year in which it ceased doing business, except where the income has already been included in the measure of a tax imposed by this chapter.

~~(2)~~

(B) The minimum tax prescribed in Section 23153.

(2) When a taxpayer ceases to do business within the state during any taxable year and does not dissolve or withdraw from the state during that year, and does not resume doing business during the succeeding taxable year, its tax for the taxable year in which it resumes doing business, on or after January 1, 2000, shall be according to or measured by its net income for the taxable year in which it resumes doing business.

(b) The tax shall be due and payable at the time the corporation resumes doing business, or on or before the

15th day of the third month following the close of its ~~income~~ *taxable* year, whichever is later. All the provisions of this part relating to delinquent taxes shall be applicable to the tax if it is not paid on or before its due date.

(c) This section does not apply to a corporation which became subject to Chapter 3 (commencing with Section 23501) after it discontinued doing business in this state (see Section 23224.5).

SEC. 58. Section 23282 of the Revenue and Taxation Code is amended to read:

23282. (a) The tax imposed upon any taxpayer which has suffered the suspension or forfeiture provided in Section 23301, and which revives in any taxable year other than the taxable year in which suspension or forfeiture occurred, shall be computed in the same manner as provided in Sections 23222 to 23224, inclusive, relative to the computation of taxes upon taxpayers commencing to do business for the first time after incorporation or qualification. In addition to the taxes, penalties, and interest specified in Section 23305, such taxpayer shall prepay a tax in an amount equal to the minimum tax provided for in Section 23153 as a condition precedent to the issuance of a certificate of revivor.

(b) After December 31, 1971, *and before January 1, 2000,* the tax imposed upon any taxpayer which has suffered the suspension or forfeiture provided in Section 23301, and which revives in any taxable year other than the taxable year in which suspension or forfeiture occurred, shall be—

(1) In the case of a taxpayer which was doing business in the year next preceding the year in which revivor took place, computed upon the basis of the net income for that next preceding income year,

(2) In the case of a taxpayer which resumed doing business in the year of revivor, computed upon the basis of the net income for the year in which it ceased doing business, unless such income is or has otherwise been subject to tax,

(3) In the case of a taxpayer which first commences to do business in the year of revivor, the minimum tax provided in Section 23153,

(4) In no event less than the minimum tax provided in Section 23153.

In addition to the taxes, penalties, and interest specified in Section 23305, such taxpayer shall prepay the minimum tax imposed by this subdivision as a condition precedent to the issuance of a certificate of revivor.

(c) After December 31, 1999, the tax imposed upon any taxpayer that has suffered the suspension or forfeiture provided in Section 23301, and that revives in any taxable year other than the taxable year in which suspension or forfeiture occurred, shall be computed upon the basis of the net income for the taxable year in which it revives, but in no event less than the minimum tax provided in Section 23153.

SEC. 59. Section 23301 of the Revenue and Taxation Code is amended to read:

23301. Except for the purposes of filing an application for exempt status or amending the articles of incorporation as necessary either to perfect that application or to set forth a new name, the corporate powers, rights and privileges of a domestic taxpayer may be suspended, and the exercise of the corporate powers, rights and privileges of a foreign taxpayer in this state may be forfeited, if any of the following conditions occur:

(a) If any tax, penalty, or interest, or any portion thereof, that is due and payable under Chapter 4 (commencing with Section 19001) of Part 10.2, or under this part, either at the time the return is required to be filed or on or before the 15th day of the ninth month following the close of the ~~income~~ *taxable* year, is not paid on or before 6 p.m. on the last day of the 12th month after the close of the ~~income~~ *taxable* year.

(b) If any tax, penalty, or interest, or any portion thereof, due and payable under Chapter 4 (commencing with Section 19001) of Part 10.2, or under this part, upon notice and demand from the Franchise Tax Board, is not

paid on or before 6 p.m. on the last day of the 11th month following the due date of the tax.

(c) If any liability, or any portion thereof, which is due and payable under Article 7 (commencing with Section 19131) of Chapter 4 of Part 10.2, is not paid on or before 6 p.m. on the last day of the 11th month following the date that the tax liability is due and payable.

SEC. 60. Section 23304.1 of the Revenue and Taxation Code is amended to read:

23304.1. (a) Every contract made in this state by a taxpayer during the time that the taxpayer's corporate powers, rights, and privileges are suspended or forfeited pursuant to Section 23301, 23301.5, or 23775 shall, subject to Section 23304.5, be voidable at the instance of any party to the contract other than the taxpayer.

(b) If a foreign taxpayer that neither is qualified to do business nor has a corporate account number from the Franchise Tax Board, fails to file a tax return required under this part, any contract made in this state by that taxpayer during the applicable period specified in subdivision (c) shall, subject to Section 23304.5, be voidable at the instance of any party to the contract other than the taxpayer.

(c) For purposes of subdivision (b), the applicable period shall be the period beginning on January 1, 1991, or the first day of the ~~income~~ *taxable* year for which the taxpayer has failed to file a return, whichever is later, and ending on the earlier of the date the taxpayer qualified to do business in this state or the date the taxpayer obtained a corporate account number from the Franchise Tax Board.

(d) If a taxpayer fails to file a tax return required under this part, to pay any tax or other amount owing to the Franchise Tax Board under this part or to file any statement or return required under Section 23772 or 23774, within 60 days after the Franchise Tax Board mails a written demand therefor, any contract made in this state by the taxpayer during the period beginning at the end of the 60-day demand period and ending on the date relief is granted under Section 23305.1, or the date the

taxpayer qualifies to do business in this state, whichever is earlier, shall be voidable at the instance of any party to the contract other than the taxpayer. This subdivision shall apply only to a taxpayer if the taxpayer has a corporate account number from the Franchise Tax Board, but has not qualified to do business under Section 2105 of the Corporations Code. In the case of a taxpayer that has not complied with the 60-day demand, the taxpayer's name, Franchise Tax Board corporate account number, date of the demand, date of the first day after the end of the 60-day demand period, and the fact that the taxpayer did not within that period pay the tax or other amount or file the statement or return, as the case may be, shall be a matter of public record.

SEC. 61. Section 23305.1 of the Revenue and Taxation Code is amended to read:

23305.1. (a) A taxpayer may make application to the Franchise Tax Board for relief from the voidability provisions of Section 23304.1. To be relieved from voidability, the taxpayer shall do all of the following:

(1) Provide the Franchise Tax Board with an application for relief from contract voidability in a form and manner prescribed by the Franchise Tax Board.

(2) Include on the application the period for which relief is requested in accordance with subdivision (b).

(3) File any tax returns required to be filed under this part with the Franchise Tax Board, including returns for the period for which relief is requested.

(4) Pay any tax, additions to tax, penalties, interest, and any other amounts owing to the Franchise Tax Board, including any liability attributable to the period for which relief is requested.

(5) Pay any penalty imposed under subdivision (b) for the period for which relief is requested.

(6) In the case of a taxpayer that applies for and enters into an approved voluntary disclosure agreement in accordance with Article 8 (commencing with Section 19191) of Chapter 4 of Part 10.2, for purposes of this section, the taxpayer shall be considered to have met the requirements of paragraphs (3), (4), and (5) if the

taxpayer fulfills to the satisfaction of the Franchise Tax Board all the specifications of the voluntary disclosure agreement within the meaning of paragraph (2) of subdivision (d) of Section 19191 and if the Franchise Tax Board has not found that any of the circumstances described in Section 19194 has rendered the voluntary disclosure agreement null and void.

(b) (1) Except as provided in paragraph (2), both of the following shall apply:

(A) The period for which relief is requested shall begin on the date that one of the taxpayer's ~~income~~ *taxable* years begins and ends on the date that relief is granted.

(B) The Franchise Tax Board shall assess a daily penalty equal to one hundred dollars ($100) for each day of the period for which relief from voidability is granted, but not to exceed a total penalty equal to the amount of the tax for the period for which relief is requested.

(2) If an application for relief from voidability is filed for a period in which an application for revivor has been filed and the certificate of revivor has been issued, all of the following shall apply:

(A) The period for which relief is requested shall begin on the date the taxpayer's powers, rights, and privileges had been suspended or forfeited and ends on the date relief is granted.

(B) The Franchise Tax Board shall assess a daily penalty equal to one hundred dollars ($100) for each day of the period for which relief from voidability is granted, but not to exceed a total penalty equal to that amount of the tax that would be imposed under Section 23151 and, except as provided in subparagraph (C), that penalty shall be equal to no less than the amount of the minimum tax provided under Section 23153 for the period for which relief is requested.

(C) In the case of an exempt organization or trust subject to Article 2 (commencing with Section 23731) of Chapter 4 (the tax on unrelated business taxable income), the daily penalty provided in subparagraph (B) shall not exceed a total penalty equal to the amount of tax

imposed upon its unrelated business taxable income for the period for which relief is requested.

(3) Any penalty imposed under this subdivision shall, subject to Section 23305.2, be due and payable on demand by the Franchise Tax Board.

(c) (1) Upon satisfaction of the conditions specified in subdivision (a), including through the application of Section 23305.2, the following shall apply:

(A) All contracts entered into during the period for which relief is granted that have not been rescinded by a final court order pursuant to Section 23304.5 may be enforced in the same manner and to the same extent, with regard to both the parties to the contract and any third parties, as if the contract had never been voidable.

(B) Any sale, transfer, or exchange of real property in California during the period for which relief is granted and which the taxpayer at that time was not entitled to sell, transfer, or exchange by reason of subdivision (d) of Section 23302 and which has not been rescinded by a final court order pursuant to Section 23304.5, shall be as valid as if the taxpayer had not been subject to subdivision (d) of Section 23302 at the time of the sale, transfer, or exchange.

(2) Upon being granted relief from voidability, the Franchise Tax Board shall certify that relief to the taxpayer in a form and manner as prescribed by the Franchise Tax Board. The certificate shall be issued or mailed to the taxpayer, or as directed by the taxpayer, and shall indicate the period for which relief is granted.

(d) The fact that a certificate of relief from voidability was issued pursuant to this section and the information contained on that certificate shall be subject to public disclosure. The certificate shall be prima facie evidence of the relief from voidability for contracts entered into during the period of relief stated on the certificate and the certificate may be recorded in the office of the county recorder of any county of this state.

(e) Subject to limitations set forth in Section 17 of Chapter 926 of the Statutes of 1990, a taxpayer that received a certificate of revivor between January 1, 1990,

and January 1, 1991, may apply for relief from voidability under this section.

SEC. 62. Section 23361 of the Revenue and Taxation Code is amended to read:

23361. ‘‘Affiliated group’’ means one or more chains of corporations connected through stock ownership with a common parent corporation if during the period when the income was accrued or realized and on the 16th day of the first month after the close of the ~~income~~ *taxable* year—

(a) At least 80 percent of the stock of each of the corporations, except the common parent corporation, is owned directly by one or more of the other corporations; and

(b) The common parent corporation owns directly at least 80 percent of the stock of at least one of the other corporations; and

(c) Each of the corporations except the common parent corporation is either (1) a corporation whose principal business is that of a common carrier by railroad or (2) a corporation the assets of which consist principally of stock in such corporations and which does not itself operate a business other than that of a common carrier by railroad. For the purpose of determining whether the principal business of a corporation is that of a common carrier by railroad, if a common carrier by railroad has leased its railroad properties and such properties are operated as such by another common carrier by railroad, the business of receiving rents for such railroad properties shall be considered as the business of a common carrier by railroad.

The provisions of this section shall not preclude the application of Chapter 17 (commencing with Section 25101) of this part.

Except in paragraph (c), ‘‘stock’’ does not include nonvoting stock which is limited and preferred as to dividends.

SEC. 63. Section 23362 of the Revenue and Taxation Code is amended to read:

23362. An affiliated group, subject to the provisions of this article, shall have the privilege of making a consolidated return for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations, which have been members of the affiliated group at any time during the ~~income~~ *taxable* year for which the return is made, consent to all regulations under Section 23363 prescribed prior to the making of such return and the making of a consolidated return shall be considered as such consent. In the case of a corporation, which is a member of the affiliated group for a fractional part of the ~~income~~ *taxable* year, the consolidated return shall include the income of such corporation for such part of the ~~income~~ *taxable* year as it is a member of the affiliated group. In the case of a common parent company which is not itself a common carrier by railroad the consolidated return shall include on a consolidated-return basis only the income received from affiliates which are common carriers by railroad.

SEC. 64. Section 23455 of the Revenue and Taxation Code is amended to read:

23455. For purposes of this part, Section 55 of the Internal Revenue Code is modified as follows:

(a) Section 55(b)(1) of the Internal Revenue Code, relating to tentative minimum tax, is modified by requiring the tentative minimum tax for the taxable year to be imposed as follows:

(1) With respect to corporations subject to tax under Chapter 2 (commencing with Section 23101), other than banks or financial corporations, according to or measured by net income, for the privilege of doing business within this state, at a rate of 7 percent upon the basis of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

(2) With respect to corporations subject to tax under Chapter 3 (commencing with Section 23501), on net income from sources within this state, at a rate of 7 percent upon the basis of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

(3) With respect to organizations or trusts subject to tax under Article 2 (commencing with Section 23731) of Chapter 4, on the unrelated business income from sources within this state, at a rate of 7 percent upon the basis of so much of the alternative taxable income for the taxable year as exceeds the exemption amount.

(4) With respect to banks subject to tax under Section 23181, according to or measured by net income, for the privilege of doing business within this state, in an amount equal to the sum of the following:

(A) At a rate of 7 percent upon the basis of so much of the alternative minimum taxable income as exceeds the exemption amount.

(B) At the rate determined under Section 23186, less the rate prescribed by Section 23151, upon the basis of net income for the taxable year.

(5) With respect to financial corporations subject to tax under Section 23183, according to or measured by net income, for the privilege of doing business within this state, in an amount equal to the sum of the following:

(A) At a rate of 7 percent upon the basis of so much of the alternative minimum taxable income as exceeds the exemption amount.

(B) At the rate determined under Section 23186, less the rate prescribed by Section 23151, upon the basis of net income for the taxable year.

(b) Section 55(b)(2) of the Internal Revenue Code, relating to the definition of alternative minimum taxable income, is modified as follows:

(1) For corporations whose net income is determined under Chapter 17 (commencing with Section 25101), alternative minimum taxable income shall be allocated and apportioned in the same manner as net income is allocated and apportioned for purposes of the regular tax.

(2) With respect to taxpayers subject to Article 4 (commencing with Section 23221) of Chapter 2, Article 4 (commencing with Section 23221) to Article 9 (commencing with Section 23361), inclusive, shall apply to the tax imposed by this section except that Section 23221 shall not apply.

(3) For purposes of computing the alternative minimum tax for taxable years in which a taxpayer commenced doing business, dissolves, withdraws, or ceases doing business, Sections 18601, 23151, 23151.1, 23151.2, 23181, 23183, 23183.1, 23183.2, 23201 to 23204, inclusive, 23222 to 23224.5, inclusive, 23282, 23332.5, and 23504 shall be applied with due regard for the rate and alternative minimum taxable income prescribed by this chapter.

(c) Section 55(c) of the Internal Revenue Code, relating to the definition of regular tax, is modified to read:

(1) For purposes of this chapter, ''regular tax'' means the amount of tax imposed under Chapter 2 (commencing with Section 23101) or Chapter 3 (commencing with Section 23501) or Article 2 (commencing with Section 23731) of Chapter 4, but does not include any amount imposed under paragraph (1) of subdivision (e) of Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

(2) The tax specified in paragraph (1) shall be the amount determined prior to reduction by any credits against the tax.

(d) The rate of 7 percent prescribed in subdivision (a) shall be 6.65 percent for any ~~income~~ *taxable* year beginning on or after January 1, 1997. The change in rate provided in this subdivision shall be made without proration otherwise required by Section 24251.

SEC. 65. Section 23456 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

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

(1) Sections 56(g)(1)(A) and 56(g)(3) of the Internal Revenue Code are modified to provide that the term

"adjusted current earnings" means the sum of the adjusted current earnings of that corporation apportionable to this state and the adjusted current earnings allocable to this state.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(2) Section 56(g)(4)(D)(ii) of the Internal Revenue Code is modified to specify that Sections 24364 and 24407 shall not apply to expenditures paid or incurred in ~~income~~ *taxable* 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 23457 of the Revenue and Taxation Code is amended to read:

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

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

(b) (1) (A) 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 24357 would be reduced if all capital gain property were taken into account at its adjusted basis.

(B) For purposes of paragraph (A), ‘‘capital gain property’’ means, with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain. For purposes of this subparagraph, any property that is property used in the trade or business, as defined in Section 1231(b) of the Internal Revenue Code, shall be treated as a capital asset.

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

(c) Section 57(a)(6) of the Internal Revenue Code, relating to accelerated depreciation or amortization on certain property placed in service before January 1, 1987, is modified to read: With respect to each property as described in Section 1250(c) of the Internal Revenue Code as that provision read on April 1, 1970, the amount by which the deduction allowable for the ~~income~~ *taxable* year for exhaustion, wear, tear, obsolescence, or

amortization exceeds the depreciation deduction which would have been allowable for the ~~income~~ *taxable* year, had the taxpayer depreciated the property under the straight line method for each ~~income~~ *taxable* year of its useful life (determined without regard to Section 24354.2 or 24381) for which the taxpayer has held the property.

SEC. 67. Section 23604 of the Revenue and Taxation Code is amended to read:

23604. For each ~~income~~ *taxable* year beginning on or after January 1, 1996, there shall be allowed as a credit against the ''tax'' (as defined by Section 23036) an amount determined as follows:

(a) (1) (A) The amount of the credit shall be equal to one-third of the federal credit computed in accordance with Section 43 of the Internal Revenue Code.

(B) If a taxpayer elects, under Section 43(e) of the Internal Revenue Code, not to apply Section 43 for federal tax purposes, this election is binding and irrevocable for state purposes, and for purposes of subparagraph (A), the federal credit shall be zero.

(2) ''Qualified enhanced oil recovery project'' shall include only projects located within California.

(3) The credit allowed under this subdivision shall not be allowed to any taxpayer for whom a depletion allowance is not permitted to be computed under Section 613 of the Internal Revenue Code by reason of paragraphs (2), (3), or (4) of subsection (d) of Section 613A of the Internal Revenue Code.

(b) Section 43(d) of the Internal Revenue Code shall apply.

(c) In the case where the credit allowed by this section exceeds the ''tax,'' the excess may be carried over to reduce the ''tax'' for the succeeding 15 years.

(d) In the case where property which qualifies as part of the taxpayer's ''qualified enhanced oil recovery costs'' also qualifies for a credit under any other section in this part, the taxpayer shall make an election on its original return as to which section applies to all costs allocable to that item of qualified property. Any election made under this section, and any specification contained in that

election, may not be revoked except with the consent of the Franchise Tax Board.

(e) No deduction shall be allowed as otherwise provided in this part for that portion of any costs paid or incurred for the ~~income~~ *taxable* year which is equal to the amount of the credit allowed under this section attributable to those costs.

(f) The basis of any property for which a credit is allowed under this section shall be reduced by the amount of the credit attributable to the property. The basis adjustment shall be made for the ~~income~~ *taxable* year for which the credit is allowed.

(g) No credit may be claimed under this section with respect to any amount for which any other credit has been claimed under this part.

SEC. 68. Section 23608 of the Revenue and Taxation Code is amended to read:

23608. (a) In the case of a taxpayer who transports any agricultural product donated in accordance with Chapter 5 (commencing with Section 58501) of Part 1 of Division 21 of the Food and Agricultural Code, for ~~income~~ *taxable* years beginning on or after January 1, 1996, there shall be allowed as a credit against the ''tax'' (as defined by Section 23036), an amount equal to 50 percent of the transportation costs paid or incurred by the taxpayer in connection with the transportation of that donated agricultural product.

(b) If two or more taxpayers share in the expenses eligible for the credit provided by this section, each taxpayer shall be eligible to receive the tax credit in proportion to its respective share of the expenses paid or incurred.

(c) If any credit allowed by this section is claimed by the taxpayer, any deduction otherwise allowed under this part for that amount of the cost paid or incurred by the taxpayer which is eligible for the credit that is claimed shall be reduced by the amount of the credit allowed.

(d) Upon delivery of the donated agricultural product by a taxpayer authorized to claim a credit pursuant to subdivision (a), the nonprofit charitable organization

shall provide a certificate to the taxpayer who transported the agricultural product. The certificate shall contain a statement signed and dated by a person authorized by that organization that the product is donated under Chapter 5 (commencing with Section 58501) of Part 1 of Division 21 of the Food and Agricultural Code. The certificate shall also contain the following information: the type and quantity of product donated, the distance transported, the name of the transporter, the name of the taxpayer donor, and the name and address of the donee. Upon the request of the Franchise Tax Board, the taxpayer shall provide a copy of the certification to the Franchise Tax Board.

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

SEC. 69. Section 23608.2 of the Revenue and Taxation Code is amended to read:

23608.2. (a) (1) For ~~income~~ *taxable* years beginning on or after January 1, 1997, there shall be allowed as a credit against the ''tax,'' as defined by Section 23036, an amount equal to the lesser of 50 percent of the eligible costs, as determined under subdivision (b), or the amount allocated under paragraph (2) of subdivision (e).

(2) Notwithstanding paragraph (1), no credit shall be allowed until the qualified year, as defined in paragraph (3).

(3) For purposes of this section, the ''qualified year'' is the first ~~income~~ *taxable* year during which the construction or rehabilitation of the qualified farmworker housing is completed and there is occupancy of the qualified farmworker housing by eligible farmworkers.

(b) (1) For purposes of this section, the ''eligible costs'' shall be equal to the total finance costs, construction costs, excavation costs, installation costs, and permit costs paid or incurred to construct or rehabilitate farmworker housing. ''Eligible costs'' include, but are not limited to, improvements to ensure compliance with laws

governing access for persons with disabilities and costs related to reducing utility expenses. Noneligible costs include land and those costs financed by grants and below-market financing.

(2) For purposes of paragraph (1), construction or rehabilitation of the farmworker housing shall have commenced on or after January 1, 1997.

(3) Notwithstanding any provision of this part, eligible costs shall not include any costs paid or incurred prior to January 1, 1997.

(c) Notwithstanding any other provision of this part, no credit shall be allowed under this section unless the taxpayer first obtains a certification from the committee that the amounts described in subdivision (b) qualify for the credit under this section and the total amount of the credit allocated to the taxpayer pursuant to the Farmworker Housing Assistance Program.

(d) The taxpayer shall do all of the following:

(1) Apply to the committee for credit certification prior to the payment or incurrence of costs described in paragraph (1) of subdivision (b).

(2) Retain a copy of the certification.

(3) Make the certification available to the Franchise Tax Board upon request.

(e) The committee shall do all of the following:

(1) Provide forms and instructions for applications for credit certification, as specified pursuant to the Farmworker Housing Assistance Program.

(2) Accept applications and issue a certificate to the taxpayer that includes a certification as to the eligible costs described in subdivision (b) that qualify for the credit and the total amount of the credit to which the taxpayer is entitled for the ~~income~~ *taxable* year. Credit in excess of the amount necessary to make the project feasible shall not be allocated. Credits shall be allocated through a minimum of one competitive funding round per year.

(3) Obtain the taxpayer's taxpayer identification number, or each shareholder's taxpayer identification

number in the case of an S corporation, for tax administration purposes.

(4) Provide an annual listing to the Franchise Tax Board, in the form and manner agreed upon by the Franchise Tax Board and the committee, containing the names, taxpayer identification numbers pursuant to paragraph (3), eligible costs, and total amount of credit certified to each taxpayer.

(f) For purposes of this section:

(1) ''Compliance period'' means, with respect to any farmworker housing, the period of 30 consecutive ~~income~~ *taxable* years, beginning with the ~~income~~ *taxable* year in which the credit is allowable.

(2) ''Construct or rehabilitate'' includes reconstruction, but does not include any costs related to acquisition or refinancing of property or structures thereon.

(3) ''Farmworker Housing Assistance Program'' means Chapter 3.7 (commencing with Section 50199.50) of Part 1 of Division 31 of the Health and Safety Code.

(4) ''Qualified farmworker housing'' means housing located within this state which satisfies the requirements of the Farmworker Housing Assistance Program. The housing may be vacant or occupied, and it need not be licensed pursuant to the Employee Housing Act at the time of the initiation of construction or rehabilitation.

(5) ''Committee'' means the California Tax Credit Allocation Committee as defined in Section 50199.7 of the Health and Safety Code.

(6) ''Qualified accountant'' means an accountant licensed or certified in this state who is neither an employee of the taxpayer, nor related to the taxpayer within the meaning of Section 267 of the Internal Revenue Code.

(g) No deduction or other credit shall be allowed under this part or Part 10 (commencing with Section 17001) to the extent of any eligible costs, as defined in subdivision (b), that are taken into account in computing the credit allowed under this section.

(h) The farmworker housing tax credit shall not be allowed unless the taxpayer:

(1) Constructs or rehabilitates the property subject to the covenants, conditions, and restrictions imposed by this section and pursuant to the Farmworker Housing Assistance Program, which shall include, but not necessarily be limited to, a requirement that the taxpayer obtain, for approval by the committee, a construction cost audit and certification of eligible costs from a qualified accountant.

(2) Subsequent to construction or rehabilitation of the farmworker housing, owns or operates the farmworker housing pursuant to the requirements of this section, or ensures the ownership and operation of the farmworker housing pursuant to the requirements of this section.

(i) The requirements of this section shall be set forth in a written agreement between the committee and the taxpayer. The agreement shall include, but not necessarily be limited to, the requirements set forth in the Farmworker Housing Assistance Program.

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

(k) (1) In the case of any disqualifying event, as defined in paragraph (2), there shall be added to the ''tax,'' as defined in Section 23036, for the ~~income~~ *taxable* year in which the disqualifying event occurs, the recapture amount computed under paragraph (3) and the interest amount computed under paragraph (4).

(2) For purposes of this subdivision, ''disqualifying event'' shall mean:

(A) The committee determines that the certification provided under subdivision (e) was obtained by fraud or misrepresentation.

(B) The taxpayer fails to comply with the requirements of the Farmworker Housing Assistance Program, or any other requirement imposed under this section.

(3) For purposes of this subdivision, ‘‘recapture amount’’ means:

(A) In the case of any disqualifying event described in subparagraph (A) of paragraph (2), the entire amount of any credit previously allowed under this section.

(B) In the case of any disqualifying event described in subparagraph (B) of paragraph (2), an amount determined by multiplying the entire amount of the credit previously allowed under this section by a fraction, the numerator of which is the number of years remaining in the compliance period and the denominator of which is 30.

(4) For purposes of this subdivision, ‘‘interest amount’’ means:

(A) In the case of any disqualifying event described in subparagraph (A) of paragraph (2), the amount of interest computed using the adjusted annual rate established in Section 19521 from the due date of the return for each ~~income~~ *taxable* year in which the credit was claimed to the date of payment of the additional tax resulting from the application of this subdivision.

(B) In the case of any disqualifying event described in subparagraph (B) of paragraph (2), zero.

(*l*) The annual amount of credit granted pursuant to this section and Sections 17053.14 and 23608.3 shall not exceed five hundred thousand dollars ($500,000), provided that the aggregate amount of the credit granted pursuant to this section and Sections 17053.14 and 23608.3 for the calendar year 1998 and thereafter may exceed five hundred thousand dollars ($500,000) per calendar year by an amount equal to any unallocated credits under this section and Sections 17053.14 and 23608.3 for the preceding calendar year or years.

SEC. 70. Section 23608.3 of the Revenue and Taxation Code is amended to read:

23608.3. (a) For ~~income~~ *taxable* years beginning on or after January 1, 1997, there shall be allowed as a credit against the ‘‘tax,’’ as defined in Section 23036, for a bank or financial corporation as determined in subdivision (b).

(b) (1) For purposes of this section, the credit shall be equal to 50 percent of the difference between the amount of interest income which could have been collected by the bank or financial corporation had the loan rate been one point above prime, or any other index used by the lender, and the lesser amount of interest income actually due for the term of the loan by the bank or financial corporation on those portions of loans used to finance only eligible costs actually paid or incurred to rehabilitate or construct qualified farmworker housing.

(2) The credit allowed under this section shall be taken in equal installments over a period equal to the lesser of 10 years or the term of the loan beginning in the taxpayer's ~~income~~ *taxable* year during which the qualified farmworker housing is completed and there is initial occupancy by eligible farmworkers. In the case where the credit allowed by this section exceeds the ''tax'' for any ~~income~~ *taxable* year, the excess may not be carried over to reduce the ''tax'' in any succeeding year.

(3) The credit shall not apply to loans with a term of less than three years or to loans funded prior to January 1, 1997. The credit shall apply only to interest income from the loan and shall not apply to any other loan fees or other charges collected by the bank or financial corporation with respect to the loan.

(c) The taxpayer shall qualify for the credit by application to and certification by the committee that the expenses qualify for the credit under this section.

(d) The taxpayer shall do all of the following:

(1) Apply to the committee for credit certification prior to the funding of the loan.

(2) Retain a copy of the certification.

(3) Make the certification available to the Franchise Tax Board upon request.

(e) The committee shall do all of the following:

(1) Provide forms and instructions for applications for credit certification, as specified pursuant to the Farmworker Housing Assistance Program.

(2) Accept applications and issue a certificate to the taxpayer that includes the credit amount to which the taxpayer is entitled for the ~~income~~ *taxable* year.

(3) Obtain the taxpayer's taxpayer identification number, and each shareholder's taxpayer identification number in the case of an S corporation, for tax administration purposes.

(4) Provide an annual listing to the Franchise Tax Board, and in a form and manner agreed upon by the Franchise Tax Board and the committee, containing the names, taxpayer identification numbers pursuant to paragraph (3), qualified amounts, and total amount of credit certified to each taxpayer.

(f) For the purposes of this section:

(1) ''Construct or rehabilitate'' includes reconstruction, but does not include any costs related to acquisition or refinancing of property or structures thereon.

(2) ''Farmworker Housing Assistance Program'' means Chapter 3.7 (commencing with Section 50199.50) of Part 1 of Division 31 of the Health and Safety Code.

(3) ''Eligible costs'' means those expenditures certified by the committee to meet the requirements of Sections 17053.14 and 23608.2.

(4) ''Qualified farmworker housing'' means housing within the state that meets the requirements of the Farmworker Housing Assistance Program.

(g) (1) In the event that the committee determines that the certification provided under subdivision (e) was obtained by fraud or misrepresentation of the taxpayer, there shall be added to the ''tax,'' as defined in Section 23036 for the ~~income~~ *taxable* year in which the disqualifying event occurs, the recapture amount computed under paragraph (2) and the interest amount computed under paragraph (3).

(2) For purposes of this subdivision, ''recapture amount'' means the entire amount of any credit previously allowed under this section.

(3) For purposes of this subdivision, ''interest amount'' means the amount of interest computed using the

adjusted annual rate established in Section 19521 from the due date of the return for the taxable year in which the credit was claimed to the date of payment of the additional tax resulting from the application of this subdivision.

(h) (1) Except as provided in paragraph (2), if the bank or financial corporation sells the loan to another bank or financial corporation, the balance of the credit, if any, shall be transferred to the assignee or transferee of the loan, subject to the same conditions and limitations as set forth in this section.

(2) A bank or financial corporation may assign, sell, or otherwise transfer the loan to another person or entity and retain the right to claim the credit granted under this section if the bank or financial corporation also retains responsibility for servicing the loan.

(i) The annual amount of credit granted pursuant to this section and Sections 17053.14 and 23608.2 shall not exceed five hundred thousand dollars ($500,000), provided that the aggregate amount of the credit granted pursuant to this section and Sections 17053.14 and 23608.2 for the 1998 calendar year and thereafter may exceed five hundred thousand dollars ($500,000) per calendar year by an amount equal to any unallocated credits under this section and Sections 17053.14 and 23608.2 for the preceding calendar year or years.

SEC. 71. Section 23609 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

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

(2) ‘‘Qualified research’’ and ‘‘basic research’’ shall include only research conducted in California.

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

(1) Basic research conducted outside California.

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

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

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

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

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

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

(2) For purposes of this subdivision:

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

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

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

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

(h) (1) For each ~~income~~ *taxable* year beginning on or after January 1, 1998:

(A) The reference to ‘‘1.65 percent’’ in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read ‘‘one and thirty-two hundredths of one percent.’’

(B) The reference to ‘‘2.2 percent’’ in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read ‘‘one and seventy-six hundredths of one percent.’’

(C) The reference to ‘‘2.75 percent’’ in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read ‘‘two and two-tenths of one percent.’’

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

(3) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held

primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

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

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

(1) The last sentence shall not apply.

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

SEC. 72. Section 23610 of the Revenue and Taxation Code is amended to read:

23610. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1997, and before January 1, 2008, there shall be allowed as a credit against the amount of ''tax,'' as defined in Section 23036, an amount equal to fifteen dollars ($15) for each ton of rice straw, as defined in Section 18944.33 of the Health and Safety Code, that is grown within California and purchased during the ~~income~~ *taxable* year by the taxpayer.

(b) The aggregate amount of tax credits granted to all taxpayers pursuant to this section and Section 17052.10 shall not exceed four hundred thousand dollars ($400,000) for each calendar year.

(c) In the case where the credit allowed by this section exceeds the ''tax,'' the excess may be carried over to reduce the ''tax'' for the next 10 ~~income~~ *taxable* years, or until the credit has been exhausted, whichever occurs first.

(d) No deduction shall be claimed for the purchase of rice straw for which a tax credit has been claimed pursuant to this section.

(e) No credit shall be claimed for the purchase of rice straw for which a tax credit has otherwise already been claimed pursuant to this part.

(f) The Department of Food and Agriculture shall do all of the following:

(1) Certify that the taxpayer has purchased the rice straw as specified in subdivision (a).

(2) Issue certificates in an aggregate amount that shall not exceed the limit specified in subdivision (b). The certificates shall be issued on a ‘‘first come, first served’’ basis to reflect the chronological order that the taxpayer submitted a valid request to the Department of Food and Agriculture.

(3) Provide an annual listing to the Franchise Tax Board (preferably on computer readable form, and in a form or manner agreed upon by the Franchise Tax Board and the Department of Food and Agriculture) of the qualified taxpayers who were issued certificates and the amount of rice straw purchased by each taxpayer.

(4) As part of its allocation request for tax credits, provide the taxpayer with a copy of the certification to retain for the taxpayer’s records.

(5) Obtain the taxpayer’s identification number, or in the case of a subchapter S corporation, the taxpayer identification numbers of all shareholders.

(6) On or before each June 1 immediately following each year for which the credit under this section is available, provide to the Legislature an informational report with respect to that year that includes all of the following:

(A) The number of tax credit certificates requested and issued.

(B) The type of businesses receiving the tax credit certificates.

(C) A general list of the methods used to process the rice straw.

(D) Recommendations on how the credits can be issued in a manner that will maximize the long term use of the California grown rice straw.

(g) To be eligible for the credit under this section the taxpayer shall do all of the following:

(1) As part of its allocation request for tax credits, provide the Department of Food and Agriculture with documents, as deemed necessary by the department, verifying the purchase of rice straw and that it meets the requirements specified in this section.

(2) Retain for the taxpayer's records a copy of the certificate issued by the Department of Food and Agriculture as specified in subdivision (f).

(3) Provide a copy of the certification specified in subdivision (f) to the Franchise Tax Board upon request. If the taxpayer fails to comply with the requirements of this subdivision, no credit shall be allowed to that taxpayer under this section for any ~~income~~ *taxable* year unless the taxpayer subsequently complies.

(4) Provide the Department of Food and Agriculture with the taxpayer's identification number, or in the case of a subchapter S corporation, the taxpayer identification numbers of all shareholders.

(h) (1) For purposes of this section, a credit shall be allowed only if the taxpayer is the ''end user'' of the rice straw. For purposes of this section, ''end user'' shall mean anyone who uses the rice straw for processing, generation of energy, manufacturing, export, prevention of erosion, or for any other purpose, exclusive of open burning, that consumes the rice straw.

(2) The credit shall not be allowed if the taxpayer is related, within the meaning of Section 267 or 318 of the Internal Revenue Code, to any person who grew the rice straw within California.

(i) This section shall remain in effect only until December 1, 2008, and as of that date is repealed.

SEC. 73. Section 23610.5 of the Revenue and Taxation Code is amended to read:

23610.5. (a) (1) There shall be allowed as a credit against the ''tax'' (as defined by Section 23036) a state low-income housing tax credit in an amount equal to the amount determined in subdivision (c), computed in

accordance with Section 42 of the Internal Revenue Code of 1986, except as otherwise provided in this section.

(2) ‘‘Taxpayer,’’ for purposes of this section, means the sole owner in the case of a C corporation, the partners in the case of a partnership, and the shareholders in the case of an S corporation.

(3) ‘‘Housing sponsor,’’ for purposes of this section, means the sole owner in the case of a C corporation, the partnership in the case of a partnership, and the S corporation in the case of an S corporation.

(b) (1) The amount of the credit allocated to any housing sponsor shall be authorized by the California Tax Credit Allocation Committee, or any successor thereof, based on a project’s need for the credit for economic feasibility in accordance with the requirements of this section.

(A) The low-income housing project shall be located in California and shall meet either of the following requirements:

(i) The project’s housing sponsor has been allocated by the California Tax Credit Allocation Committee a credit for federal income tax purposes under Section 42 of the Internal Revenue Code.

(ii) It qualifies for a credit under Section 42(h)(4)(B) of the Internal Revenue Code.

(B) The California Tax Credit Allocation Committee shall not require fees for the credit under this section in addition to those fees required for applications for the tax credit pursuant to Section 42 of the Internal Revenue Code. The committee may require a fee if the application for the credit under this section is submitted in a calendar year after the year the application is submitted for the federal tax credit.

(2) (A) The California Tax Credit Allocation Committee shall certify to the housing sponsor the amount of tax credit under this section allocated to the housing sponsor for each credit period.

(B) In the case of a partnership or an S corporation, the housing sponsor shall provide a copy of the California Tax

Credit Allocation Committee certification to the taxpayer.

(C) The taxpayer shall, upon request, provide a copy of the certification to the Franchise Tax Board.

(D) All elections made by the taxpayer pursuant to Section 42 of the Internal Revenue Code shall apply to this section.

(E) For buildings located in designated difficult development areas or qualified census tracts as defined in Section 42(d)(5)(C) of the Internal Revenue Code, credits may be allocated under this section in the amounts prescribed in subdivision (c), provided that the amount of credit allocated under Section 42 of the Internal Revenue Code is computed on 100 percent of the qualified basis of the building.

(c) Section 42(b) of the Internal Revenue Code shall be modified as follows:

(1) In the case of any qualified low-income building placed in service by the housing sponsor during 1987, the term ‘‘applicable percentage’’ means 9 percent for each of the first three years and 3 percent for the fourth year for new buildings (whether or not the building is federally subsidized) and for existing buildings.

(2) In the case of any qualified low-income building that receives an allocation after 1989 and is a new building not federally subsidized, the term ‘‘applicable percentage’’ means the following:

(A) For each of the first three years, the percentage prescribed by the Secretary of the Treasury for new buildings that are not federally subsidized for the taxable year, determined in accordance with the requirements of Section 42(b)(2) of the Internal Revenue Code, in lieu of the percentage prescribed in Section 42(b)(1)(A).

(B) For the fourth year, the difference between 30 percent and the sum of the applicable percentages for the first three years.

(3) In the case of any qualified low-income building that receives an allocation after 1989 and that is a new building that is federally subsidized or that is an existing

building that is ‘‘at risk of conversion,’’ the term ‘‘applicable percentage’’ means the following:

(A) For each of the first three years, the percentage prescribed by the Secretary of the Treasury for new buildings that are federally subsidized for the taxable year.

(B) For the fourth year, the difference between 13 percent and the sum of the applicable percentages for the first three years.

(4) For purposes of this section, the term ‘‘at risk of conversion,’’ with respect to an existing building means a building that satisfies all of the following criteria:

(A) The building is presently owned by a housing sponsor other than a qualified nonprofit organization.

(B) The building is a federally assisted building for which the low-income use restrictions will terminate or the building is eligible for prepayment under Subtitle 13 of the Emergency Low Income Housing Assistance Act of 1987 or under Section 502(c) of the Housing Act of 1949, anytime in the two calendar years after the year of application to the California Tax Credit Allocation Committee, and the purchaser has received preliminary approval from the applicable federal agency for a maximum level of incentives through a plan of action.

(C) The person acquiring the building enters into a regulatory agreement that requires the building to be operated in accordance with the requirements of this section for a period equal to the greater of 55 years or the life of the building.

(D) The building satisfies the requirements of Section 42(e) of the Internal Revenue Code regarding rehabilitation expenditures, except that the provisions of Section 42(e)(3)(A)(ii)(I) shall not apply.

(d) The term ‘‘qualified low-income housing project’’ as defined in Section 42(c)(2) of the Internal Revenue Code is modified by adding the following requirements:

(1) The taxpayer shall be entitled to receive a cash distribution from the operations of the project, after funding required reserves, which, at the election of the taxpayer, shall be equal to:

(A) An amount not to exceed 8 percent of the lesser of:

(i) The owner equity, which shall include the amount of the capital contributions actually paid to the housing sponsor and shall not include any amounts until they are paid on an investor note, or

(ii) Twenty percent of the adjusted basis of the building as of the close of the first ~~income~~ *taxable* year of the credit period; or

(B) The amount of the cash-flow from those units in the building that are not low-income units. For purposes of computing cash-flow under this subparagraph, operating costs shall be allocated to the low-income units using the ''floor space fraction,'' as defined in Section 42 of the Internal Revenue Code.

(C) Any amount allowed to be distributed under subparagraph (A) that is not available for distribution during the first five years of the compliance period may accumulate and be distributed at any time during the first 15 years of the compliance period but not thereafter.

(2) The limitation on return shall apply in the aggregate to the partners if the housing sponsor is a partnership and in the aggregate to the shareholders if the housing sponsor is an S corporation.

(3) The housing sponsor shall apply any cash available for distribution in excess of the amount eligible to be distributed under paragraph (1) to reduce the rent on rent-restricted units or to increase the number of rent-restricted units subject to the tests of Section 42(g)(1) of the Internal Revenue Code.

(e) The provisions of Section 42(f) of the Internal Revenue Code shall be modified as follows:

(1) The term ''credit period'' as defined in Section 42(f)(1) of the Internal Revenue Code is modified by substituting ''four ~~income~~ *taxable* years'' for ''10 taxable years.''

(2) The special rule for the first taxable year of the credit period under Section 42(f)(2) of the Internal Revenue Code shall not apply to the tax credit under this section.

(3) Section 42(f)(3) of the Internal Revenue Code is modified to read:

If, as of the close of any ~~income~~ *taxable* year in the compliance period, after the first year of the credit period, the qualified basis of any building exceeds the qualified basis of that building as of the close of the first year of the credit period, the housing sponsor, to the extent of its tax credit allocation, shall be eligible for a credit on the excess in an amount equal to the applicable percentage determined pursuant to subdivision (c) for the four-year period beginning with the later of the ~~income~~ *taxable* years in which the increase in qualified basis occurs.

(f) The provisions of Section 42(h) of the Internal Revenue Code shall be modified as follows:

(1) Section 42(h)(2) of the Internal Revenue Code shall not be applicable and instead the following provisions shall be applicable:

The total amount for the four-year credit period of the housing credit dollars allocated in a calendar year to any building shall reduce the aggregate housing credit dollar amount of the California Tax Credit Allocation Committee for the calendar year in which the allocation is made.

(2) Paragraphs (3), (4), (5), (6)(E)(i)(II), (6)(F), (6)(G), (6)(I), (7), and (8) of Section 42(h) of the Internal Revenue Code shall not be applicable.

(g) The aggregate housing credit dollar amount that may be allocated annually by the California Tax Credit Allocation Committee pursuant to this section, Section 12206, and Section 17058 shall be an amount equal to the sum of the following:

(1) (A) Except as provided in subparagraph (B), thirty-five million dollars ($35,000,000) for the 1997 calendar year, and each calendar year thereafter, or

(B) Fifty million dollars ($50,000,000) for each of the calendar years 1998 and 1999; and

(2) The unused housing credit ceiling, if any, for the preceding calendar years; and

(3) The amount of housing credit ceiling returned in the calendar year. For purposes of this paragraph, the amount of housing credit dollar amount returned in the calendar year equals the housing credit dollar amount previously allocated to any project that does not become a qualified low-income housing project within the period required by this section or to any project with respect to which an allocation is canceled by mutual consent of the California Tax Credit Allocation Committee and the allocation recipient.

(h) The term ‘‘compliance period’’ as defined in Section 42(i)(1) of the Internal Revenue Code is modified to mean, with respect to any building, the period of 30 consecutive ~~income~~ *taxable* years beginning with the first ~~income~~ *taxable* year of the credit period with respect thereto.

(i) Section 42(j) of the Internal Revenue Code shall not be applicable and the following shall be substituted in its place:

The requirements of this section shall be set forth in a regulatory agreement between the California Tax Credit Allocation Committee and the housing sponsor, and this agreement shall be subordinated, when required, to any lien or encumbrance of any banks or other institutional lenders to the project. The regulatory agreement entered into pursuant to subdivision (f) of Section 50199.14 of the Health and Safety Code shall apply, provided that the agreement includes all of the following provisions:

(1) A term not less than the compliance period.

(2) A requirement that the agreement be filed in the official records of the county in which the qualified low-income housing project is located.

(3) A provision stating which state and local agencies can enforce the regulatory agreement in the event the housing sponsor fails to satisfy any of the requirements of this section.

(4) A provision that the regulatory agreement shall be deemed a contract enforceable by tenants as third-party beneficiaries thereto, and that allows individuals, whether prospective, present, or former occupants of the

building, who meet the income limitation applicable to the building the right to enforce the regulatory agreement in any state court.

(5) A provision incorporating the requirements of Section 42 of the Internal Revenue Code as modified by this section.

(6) A requirement that the housing sponsor notify the California Tax Credit Allocation Committee or its designee if there is a determination by the Internal Revenue Service that the project is not in compliance with Section 42(g) of the Internal Revenue Code.

(7) A requirement that the housing sponsor, as security for the performance of the housing sponsor's obligations under the regulatory agreement, assign the housing sponsor's interest in rents that it receives from the project, provided that until there is a default under the regulatory agreement, the housing sponsor is entitled to collect and retain the rents.

(8) A provision that the remedies available in the event of a default under the regulatory agreement that is not cured within a reasonable cure period include, but are not limited to, allowing any of the parties designated to enforce the regulatory agreement to collect all rents with respect to the project; taking possession of the project and operating the project in accordance with the regulatory agreement until the enforcer determines the housing sponsor is in a position to operate the project in accordance with the regulatory agreement; applying to any court for specific performance; securing the appointment of a receiver to operate the project; or any other relief as may be appropriate.

(j) (1) The committee shall allocate the housing credit on a regular basis consisting of two or more periods in each calendar year during which applications may be filed and considered. The committee shall establish application filing deadlines, the maximum percentage of federal and state low-income housing tax credit ceiling that may be allocated by the committee in that period, and the approximate date on which allocations shall be made. If the enactment of federal or state law, the

adoption of rules or regulations, or other similar events prevent the use of two allocation periods, the committee may reduce the number of periods and adjust the filing deadlines, maximum percentage of credit allocated, and allocation dates.

(2) The committee shall adopt a qualified allocation plan, as provided in Section 42(m)(1) of the Internal Revenue Code. In adopting this plan, the committee shall comply with the provisions of Sections 42(m)(1)(B) and 42(m)(1)(C) of the Internal Revenue Code.

(3) Notwithstanding Section 42(m) of the Internal Revenue Code, the California Tax Credit Allocation Committee shall allocate housing credits in accordance with the qualified allocation plan and regulations, which shall include the following provisions:

(A) All housing sponsors, as defined by paragraph (3) of subdivision (a), shall demonstrate at the time the application is filed with the committee that the project meets the following threshold requirements:

(i) The housing sponsor shall demonstrate that there is a need for low-income housing in the community or region for which it is proposed.

(ii) The project's proposed financing, including tax credit proceeds, shall be sufficient to complete the project and shall be adequate to operate the project for the extended use period.

(iii) The project shall have enforceable financing commitments, either construction or permanent financing, for at least 50 percent of the total estimated financing of the project.

(iv) The housing sponsor shall have and maintain control of the site for the project.

(v) The housing sponsor shall demonstrate that the project complies with all applicable local land use and zoning ordinances.

(vi) The housing sponsor shall demonstrate that the project development team has the experience and the financial capacity to ensure project completion and operation for the extended use period.

(vii) The housing sponsor shall demonstrate the amount of tax credit that is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the extended use period, taking into account operating expenses, a supportable debt service, reserves, funds set aside for rental subsidies, and required equity, and a development fee that does not exceed a specified percentage of the eligible basis of the project prior to inclusion of the development fee in the eligible basis, as determined by the committee.

(B) The committee shall give a preference to those projects satisfying all of the threshold requirements of subparagraph (A) if:

(i) The project serves the lowest income tenants at rents affordable to those tenants; and

(ii) The project is obligated to serve qualified tenants for the longest period.

(C) In addition to the provisions of subparagraphs (A) and (B), the committee shall use the following criteria in allocating housing credits:

(i) Projects serving large families in which a substantial number, as defined by the committee, of all residential units are low-income units with three and more bedrooms.

(ii) Projects providing single-room occupancy units serving very low income tenants.

(iii) Existing projects that are ‘‘at risk of conversion,’’ as defined by paragraph (4) of subdivision (c).

(iv) Projects for which a public agency provides direct or indirect long-term financial support for at least 15 percent of the total project development costs or projects for which the owner’s equity constitutes at least 30 percent of the total project development costs.

(v) Projects that provide tenant amenities not generally available to residents of low-income housing projects.

(4) For purposes of allocating credits pursuant to this section, the committee shall not give preference to any project by virtue of the date of submission of its

application except to break a tie when two or more of the projects have an equal rating.

(5) Not less than 20 percent of the low-income housing tax credits available annually under this section, Section 12206, and Section 17058 shall be set aside for allocation to rural areas as defined in Section 50199.21 of the Health and Safety Code. Any amount of credit set aside for rural areas remaining on or after October 31 of any calendar year shall be available for allocation to any eligible project. No amount of credit set aside for rural areas shall be considered available for any eligible project so long as there are eligible rural applications pending on October 31.

(k) Section 42(*l*) of the Internal Revenue Code shall be modified as follows:

The term ‘‘secretary’’ shall be replaced by the term ‘‘California Franchise Tax Board.’’

(*l*) In the case where the state credit allowed under this section exceeds the ‘‘tax,’’ the excess may be carried over to reduce the ‘‘tax’’ in the following year, and succeeding years if necessary, until the credit has been exhausted.

(m) A project that received an allocation of a 1989 federal housing credit dollar amount shall be eligible to receive an allocation of a 1990 state housing credit dollar amount, subject to all of the following conditions:

(1) The project was not placed in service prior to 1990.

(2) To the extent the amendments made to this section by the Statutes of 1990 conflict with any provisions existing in this section prior to those amendments, the prior provisions of law shall prevail.

(3) Notwithstanding paragraph (2), a project applying for an allocation under this subdivision shall be subject to the requirements of paragraph (3) of subdivision (j).

(n) The credit period with respect to an allocation of credit in 1989 by the California Tax Credit Allocation Committee of which any amount is attributable to unallocated credit from 1987 or 1988 shall not begin until after December 31, 1989.

(o) The provisions of Section 11407(a) of Public Law 101-508, relating to the effective date of the extension of the low-income housing credit, shall apply to calendar years after 1989.

(p) The provisions of Section 11407(c) of Public Law 101-508, relating to election to accelerate credit, shall not apply.

(q) (1) A corporation may elect to assign any portion of any credit allowed under this section to one or more affiliated corporations for each ~~income~~ *taxable* year in which the credit is allowed. For purposes of this subdivision, ''affiliated corporation'' has the meaning provided in subdivision (b) of Section 25110, as that section was amended by Chapter 881 of the Statutes of 1993, as of the last day of the ~~income~~ *taxable* year in which the credit is allowed, except that ''100 percent'' is substituted for ''more than 50 percent'' wherever it appears in the section, as that section was amended by Chapter 881 of the Statutes of 1993, and ''voting common stock'' is substituted for ''voting stock'' wherever it appears in the section, as that section was amended by Chapter 881 of the Statutes of 1993.

(2) The election provided in paragraph (1):

(A) May be based on any method selected by the corporation that originally receives the credit.

(B) Shall be irrevocable for the ~~income~~ *taxable* year the credit is allowed, once made.

(C) May be changed for any subsequent ~~income~~ *taxable* year if the election to make the assignment is expressly shown on each of the returns of the affiliated corporations that assign and receive the credits.

(r) Any unused credit may continue to be carried forward, as provided in subdivision (k), until the credit has been exhausted.

This section shall remain in effect on or after December 1, 1990, for as long as Section 42 of the Internal Revenue Code, pertaining to low-income housing credits, remains in effect.

(s) The amendments to this section made by the act adding this subdivision shall apply only to ~~income~~ *taxable*

years beginning on or after January 1, 1994, except that paragraph (1) of subdivision (q), as amended, shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1993.

SEC. 74. Section 23612.2 of the Revenue and Taxation Code is amended to read:

23612.2. (a) There shall be allowed as a credit against the ''tax'' (as defined by Section 23036) for the ~~income~~ *taxable* year an amount equal to the sales or use tax paid or incurred during the ~~income~~ *taxable* year by the taxpayer in connection with the taxpayer's purchase of qualified property.

(b) For purposes of this section:

(1) ''Taxpayer'' means a corporation engaged in a trade or business within an enterprise zone.

(2) ''Qualified property'' means:

(A) Any of the following:

(i) Machinery and machinery parts used for fabricating, processing, assembling, and manufacturing.

(ii) Machinery and machinery parts used for the production of renewable energy resources.

(iii) Machinery and machinery parts used for either of the following:

(I) Air pollution control mechanisms.

(II) Water pollution control mechanisms.

(iv) Data-processing and communications equipment, including, but not limited to, computers, computer-automated drafting systems, copy machines, telephone systems, and faxes.

(v) Motion picture manufacturing equipment central to production and postproduction, including, but not limited to, cameras, audio recorders, and digital image and sound processing equipment.

(B) The total cost of qualified property purchased and placed in service in any ~~income~~ *taxable* year that may be taken into account by any taxpayer for purposes of claiming this credit shall not exceed twenty million dollars ($20,000,000).

(C) The qualified property is used by the taxpayer exclusively in an enterprise zone.

(D) The qualified property is purchased and placed in service before the date the enterprise zone designation expires, is no longer binding, or becomes inoperative.

(3) ‘‘Enterprise zone’’ means the area designated as an enterprise zone pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(c) If the taxpayer has purchased property upon which a use tax has been paid or incurred, the credit provided by this section shall be allowed only if qualified property of a comparable quality and price is not timely available for purchase in this state.

(d) In the case where the credit otherwise allowed under this section exceeds the ‘‘tax’’ for the ~~income~~ *taxable* year, that portion of the credit which exceeds the ‘‘tax’’ may be carried over and added to the credit, if any, in the following year, and succeeding years if necessary, until the credit is exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(e) Any taxpayer who elects to be subject to this section shall not be entitled to increase the basis of the qualified property as otherwise required by Section 164(a) of the Internal Revenue Code with respect to sales or use tax paid or incurred in connection with the taxpayer’s purchase of qualified property.

(f) (1) The amount of credit otherwise allowed under this section and Section 23622.7, including any credit carryover from prior years, that may reduce the ‘‘tax’’ for the ~~income~~ *taxable* year shall not exceed the amount of tax which would be imposed on the taxpayer’s business income attributable to the enterprise zone determined as if that attributable income represented all of the income of the taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer’s California source business income that is apportioned to the enterprise zone. For that purpose, the taxpayer’s business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the

enterprise zone in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Business income shall be apportioned to the enterprise zone by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the enterprise zone during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the enterprise zone during the taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the taxable year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (d).

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

SEC. 75. Section 23617 of the Revenue and Taxation Code is amended to read:

23617. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1988, and before January 1, 2003, there shall be allowed as a credit against the ''tax'' (as defined by Section 23036) an amount equal to the amount determined in subdivision (b).

(b) (1) The amount of the credit allowed by this section shall be 30 percent of any of the following:

(A) The cost paid or incurred by the taxpayer on or after September 23, 1988, for the startup expenses of establishing a child care program or constructing a child care facility in California, to be used primarily by the children of the taxpayer's employees.

(B) For each ~~income~~ *taxable* year beginning on or after January 1, 1993, *the* cost paid or incurred by the taxpayer for startup expenses of establishing a child care program or constructing a child care facility in California to be used primarily by the children of employees of tenants leasing commercial or office space in a building owned by the taxpayer.

(C) The cost paid or incurred by the taxpayer on or after September 23, 1988, for contributions to California child care information and referral services, including, but not limited to, those that identify local child care services, offer information describing these resources to the taxpayer's employees, and make referrals of the taxpayer's employees to child care services where there are vacancies.

In the case of a child care facility established by two or more taxpayers, the credit shall be allowed if the facility is to be used primarily by the children of the employees of each of the taxpayers or the children of the employees of tenants of each of the taxpayers.

(2) The amount of the credit allowed by this section shall not exceed fifty thousand dollars ($50,000) for any ~~income~~ *taxable* year.

(c) For purposes of this section, ''startup expenses'' include, but are not limited to, feasibility studies, site preparation, and construction, renovation, or acquisition of facilities for purposes of establishing or expanding onsite or nearsite centers by one or more employers or one or more building owners leasing space to employers.

(d) If two or more taxpayers share in the costs eligible for the credit provided by this section, each taxpayer shall be eligible to receive a tax credit with respect to its respective share of the costs paid or incurred.

(e) (1) In the case where the credit allowed and limited under subdivision (b) for the ~~income~~ *taxable* year

exceeds the ''tax,'' the excess may be carried over to reduce the ''tax'' in the following year, and succeeding years if necessary, until the credit has been exhausted. However, the excess from any one year shall not exceed fifty thousand dollars ($50,000).

(2) If the credit carryovers from preceding ~~income~~ *taxable* years allowed under paragraph (1) plus the credit allowed for the ~~income~~ *taxable* year under subdivision (b) would exceed an aggregate total of fifty thousand dollars ($50,000), then the credit allowed to reduce the ''tax'' under this section for the ~~income~~ *taxable* year shall be limited to fifty thousand dollars ($50,000) and the amount in excess of the fifty thousand dollar ($50,000) limit may be carried over and applied against the ''tax'' in the following year, and succeeding years if necessary, in an amount which, when added to the credit allowed under subdivision (b) for that succeeding ~~income~~ *taxable* year, does not exceed fifty thousand dollars ($50,000).

(f) No deduction shall be allowed as otherwise provided in this part for that portion of expenses paid or incurred for the ~~income~~ *taxable* year which is equal to the amount of the credit allowed under this section attributable to those expenses.

(g) In lieu of claiming the tax credit provided by this section, the taxpayer may elect to take depreciation pursuant to Section 24371.5. In addition, the taxpayer may take depreciation pursuant to that section for the cost of a facility in excess of the amount of the tax credit claimed under this section.

(h) The basis for any child care facility for which a credit is allowed shall be reduced by the amount of the credit attributable to the facility. The basis adjustment shall be made for the taxable year for which the credit is allowed.

(i) No credit shall be allowed under subparagraph (B) of paragraph (1) of subdivision (b) in the case of any taxpayer that is required by any local ordinance or regulation to provide a child care facility.

(j) (1) In order to be eligible for the credit allowed under subparagraph (A) or (B) of paragraph (1) of

subdivision (b), the taxpayer shall submit to the Franchise Tax Board upon request a statement certifying that the costs for which the credit is claimed are incurred with respect to the startup expenses of establishing a child care program or constructing a child care facility in California to be used primarily by the children of the taxpayer's employees or the children of the employees of tenants leasing commercial or office space in a building owned by the taxpayer and which will be in operation for at least 60 consecutive months after completion.

(2) If the child care center for which a credit is claimed pursuant to this section is disposed of or ceases to operate within 60 months after completion, that portion of the credit claimed which represents the remaining portion of the 60-month period shall be added to the taxpayer's tax liability in the ~~income~~ *taxable* year of that disposition or nonuse.

(k) In order to be allowed the credit under subparagraph (A) or (B) of paragraph (1) of subdivision (b), the taxpayer shall indicate, in the form and manner prescribed by the Franchise Tax Board, the number of children that the child care program or facility will be able to legally accommodate.

(*l*) This section shall remain in effect only until December 1, 2003, and as of that date is repealed.

SEC. 76. Section 23617.5 of the Revenue and Taxation Code is amended to read:

23617.5. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1995, and before January 1, 2003, there shall be allowed as a credit against the ''tax'' (as defined by Section 23036) an amount equal to the amount determined in subdivision (b).

(b) (1) The amount of the credit allowed by this section shall be 30 percent of the cost paid or incurred by the taxpayer for contributions to a qualified care plan made on behalf of any qualified dependent of the taxpayer's qualified employee.

(2) The amount of the credit allowed by this section in any ~~income~~ *taxable* year shall not exceed three hundred sixty dollars ($360) for each qualified dependent.

(c) For purposes of this section:

(1) ‘‘Qualified care plan’’ means a plan providing qualified care.

(2) ‘‘Qualified care’’ includes, but is not limited to, onsite service, center-based service, in-home care or home-provider care, and a dependent care center as defined by Section 21(b)(2)(D) of the Internal Revenue Code that is a specialized center with respect to short-term illnesses of an employee’s dependents. ‘‘Qualified care’’ must be provided in this state under the authority of a license when required by California law.

(3) ‘‘Specialized center’’ means a facility that provides care to mildly ill children and that may do all of the following:

(A) Be staffed by pediatric nurses and day care workers.

(B) Admit children suffering from common childhood ailments (including colds, flu, and chickenpox).

(C) Make special arrangements for well children with minor problems associated with diabetes, asthma, breaks or sprains, and recuperation from surgery.

(D) Separate children according to their illness and symptoms in order to protect them from cross-infection.

(4) ‘‘Contributions’’ include direct payments to child care programs or providers.

(5) ‘‘Qualified employee’’ means any employee of the taxpayer who is performing services for the taxpayer in this state, within the meaning of Section 25133, during the period in which the qualified care is performed.

(6) ‘‘Employee’’ includes an individual who is an employee within the meaning of Section 401(c)(1) of the Internal Revenue Code (relating to self-employed individuals).

(7) ‘‘Qualified dependent’’ means any dependent of a qualified employee who is under the age of 12 years.

(d) If an employer makes contributions to a qualified care plan and also collects fees from parents to support a child care facility owned and operated by the employer, no credit shall be allowed under this section for contributions in the amount, if any, by which the sum of

the contributions and fees exceed the total cost of providing care. The Franchise Tax Board may require information about fees collected from parents of children served in the facility from taxpayers claiming credits under this section.

(e) If the duration of the child care received is less than 42 weeks, the employer shall claim a prorated portion of the allowable credit. The employer shall prorate the credit using the ratio of the number of weeks of care received divided by 42 weeks.

(f) If the credit allowed under this section exceeds the ''tax,'' the excess may be carried over to reduce the ''tax'' in the following year, and succeeding years if necessary, until the credit has been exhausted.

(g) The credit shall not be available to an employer if the care provided on behalf of an employee is provided by an individual who:

(1) Qualifies as a dependent of that employee or that employee's spouse under subdivision (d) of Section 17054.

(2) Is (within the meaning of Section 17056) a son, stepson, daughter, or stepdaughter of that employee and is under the age of 19 at the close of that taxable year.

(h) The contributions to a qualified care plan shall not discriminate in favor of employees who are officers, owners, or highly compensated, or their dependents.

(i) No deduction shall be allowed as otherwise provided in this part for that portion of expenses paid or incurred for the ~~income~~ *taxable* year that is equal to the amount of the credit allowed under this section.

(j) If the credit is taken by an employer for contributions to a qualified care plan that is used at a facility owned by the employer, the basis of that facility shall be reduced by the amount of the credit. The basis adjustment shall be made for the ~~income~~ *taxable* year for which the credit is allowed.

(k) This section shall remain in effect only until December 1, 2003, and as of that date is repealed.

SEC. 77. Section 23621 of the Revenue and Taxation Code is amended to read:

23621. (a) There shall be allowed as a credit against the ‘‘tax’’ (as defined by Section 23036) an amount equal to 10 percent of the amount of wages paid to each employee who is certified by the Employment Development Department to meet the requirements of Section 328 of the Unemployment Insurance Code.

The credit under this section shall not apply to an individual unless, on or before the day on which that individual begins work for the employer, the employer:

(1) Has received a certification from the Employment Development Department, or

(2) Has requested in writing that certification from the Employment Development Department.

For purposes of this subdivision, if on or before the day on which the individual begins work for the employer, the individual has received from the Employment Development Department a written preliminary determination that he or she is a member of a targeted group, then the requirement of paragraph (1) or (2) shall be applicable on or before the fifth day on which the individual begins work for the employer.

(b) The credit under this section shall not apply to wages paid in excess of three thousand dollars ($3,000) during an ~~income~~ *taxable* year by a taxpayer to the same individual. With respect to each qualified employee, the aggregate credit under this section shall not exceed six hundred dollars ($600).

(c) The credit under this section shall not apply to wages paid to an individual:

(1) Who is a dependent, as described in paragraphs (1) to (8), inclusive, of Section 152(a) of the Internal Revenue Code, of an individual who owns, directly or indirectly, more than 50 percent in value of the outstanding stock of the taxpayer (determined with the application of Section 267(c) of the Internal Revenue Code); or

(2) Who is a dependent (as described in paragraph (9) of Section 152(a) of the Internal Revenue Code) of an individual described in paragraph (1).

(d) The credit under this section shall not apply to wages paid to an individual if, prior to the hiring date of that individual, that individual had been employed by the employer at any time during which he or she was not certified by the Employment Development Department to meet the requirements of Section 328 of the Unemployment Insurance Code.

(e) If the certification of an employee has been revoked pursuant to subdivision (c) of Section 328 of the Unemployment Insurance Code, the credit under this section shall not apply to wages paid by the employer after the date on which notice of revocation is received by the employer.

(f) The credit under this section shall be in addition to any deduction under this part to which the taxpayer may be entitled, if any.

(g) The credit provided by this section shall be applied to wages paid to each qualifying employee during the 24-month period beginning on the date the employee begins working for the taxpayer.

(h) (1) A taxpayer may elect to have this section not apply for any ~~income~~ *taxable* year.

(2) An election under paragraph (1) for any ~~income~~ *taxable* year may be made (or revoked) at any time before the expiration of the four-year period beginning on the last date prescribed by law for filing the return for that ~~income~~ *taxable* year (determined without regard to extensions).

(3) An election under paragraph (1) (or revocation thereof) shall be made in any manner which the Franchise Tax Board may prescribe.

(i) (1) In the case of a successor employer referred to in Section 3306(b)(1) of the Internal Revenue Code, the determination of the amount of the credit under this section with respect to wages paid by that successor employer shall be made in the same manner as if those wages were paid by the predecessor employer referred to in that section.

(2) No credit shall be determined under this section with respect to remuneration paid by an employer to an

employee for services performed by that employee for another person unless the amount reasonably expected to be received by the employer for those services from that other person exceeds the remuneration paid by the employer to that employee for those services.

(j) The term ''wages'' shall not include either of the following:

(1) Payments defined in Section 51(c)(3) of the Internal Revenue Code, relating to payments for services during labor disputes.

(2) Any amounts paid or incurred to an individual who begins work for an employer after December 31, 1993.

SEC. 78. Section 23622.7 of the Revenue and Taxation Code is amended to read:

23622.7. (a) There shall be allowed a credit against the ''tax'' (as defined by Section 23036) to a taxpayer who employs a qualified employee in an enterprise zone during the ~~income~~ *taxable* year. The credit shall be equal to the sum of each of the following:

(1) Fifty percent of qualified wages in the first year of employment.

(2) Forty percent of qualified wages in the second year of employment.

(3) Thirty percent of qualified wages in the third year of employment.

(4) Twenty percent of qualified wages in the fourth year of employment.

(5) Ten percent of qualified wages in the fifth year of employment.

(b) For purposes of this section:

(1) ''Qualified wages'' means:

(A) (i) Except as provided in clause (ii), that portion of wages paid or incurred by the taxpayer during the ~~income~~ *taxable* year to qualified employees that does not exceed 150 percent of the minimum wage.

(ii) For up to 1,350 qualified employees who are employed by the taxpayer in the Long Beach Enterprise Zone in aircraft manufacturing activities described in Codes 3721 to 3728, inclusive, and Code 3812 of the Standard Industrial Classification (SIC) Manual

published by the United States Office of Management and Budget, 1987 edition, ‘‘qualified wages’’ means that portion of hourly wages that does not exceed 202 percent of the minimum wage.

(B) Wages received during the 60-month period beginning with the first day the employee commences employment with the taxpayer. Reemployment in connection with any increase, including a regularly occurring seasonal increase, in the trade or business operations of the taxpayer does not constitute commencement of employment for purposes of this section.

(C) Qualified wages do not include any wages paid or incurred by the taxpayer on or after the zone expiration date. However, wages paid or incurred with respect to qualified employees who are employed by the taxpayer within the enterprise zone within the 60-month period prior to the zone expiration date shall continue to qualify for the credit under this section after the zone expiration date, in accordance with all provisions of this section applied as if the enterprise zone designation were still in existence and binding.

(2) ‘‘Minimum wage’’ means the wage established by the Industrial Welfare Commission as provided for in Chapter 1 (commencing with Section 1171) of Part 4 of Division 2 of the Labor Code.

(3) ‘‘Zone expiration date’’ means the date the enterprise zone designation expires, is no longer binding, or becomes inoperative.

(4) (A) ‘‘Qualified employee’’ means an individual who meets all of the following requirements:

(i) At least 90 percent of whose services for the taxpayer during the ~~income~~ *taxable* year are directly related to the conduct of the taxpayer’s trade or business located in an enterprise zone.

(ii) Performs at least 50 percent of his or her services for the taxpayer during the ~~income~~ *taxable* year in an enterprise zone.

(iii) Is hired by the taxpayer after the date of original designation of the area in which services were performed as an enterprise zone.

(iv) Is any of the following:

(I) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a person eligible for services under the federal Job Training Partnership Act (29 U.S.C. Sec. 1501 et seq.), or its successor, who is receiving, or is eligible to receive, subsidized employment, training, or services funded by the federal Job Training Partnership Act, or its successor.

(II) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a person eligible to be a voluntary or mandatory registrant under the Greater Avenues for Independence Act of 1985 (GAIN) provided for pursuant to Article 3.2 (commencing with Section 11320) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code, or its successor.

(III) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was an economically disadvantaged individual 14 years of age or older.

(IV) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a dislocated worker who meets any of the following:

(aa) Has been terminated or laid off or who has received a notice of termination or layoff from employment, is eligible for or has exhausted entitlement to unemployment insurance benefits, and is unlikely to return to his or her previous industry or occupation.

(bb) Has been terminated or has received a notice of termination of employment as a result of any permanent closure or any substantial layoff at a plant, facility, or enterprise, including an individual who has not received written notification but whose employer has made a public announcement of the closure or layoff.

(cc) Is long-term unemployed and has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the

individual resides, including an individual 55 years of age or older who may have substantial barriers to employment by reason of age.

(dd) Was self-employed (including farmers and ranchers) and is unemployed as a result of general economic conditions in the community in which he or she resides or because of natural disasters.

(ee) Was a civilian employee of the Department of Defense employed at a military installation being closed or realigned under the Defense Base Closure and Realignment Act of 1990.

(ff) Was an active member of the armed forces or National Guard as of September 30, 1990, and was either involuntarily separated or separated pursuant to a special benefits program.

(gg) Is a seasonal or migrant worker who experiences chronic seasonal unemployment and underemployment in the agriculture industry, aggravated by continual advancements in technology and mechanization.

(hh) Has been terminated or laid off, or has received a notice of termination or layoff, as a consequence of compliance with the Clean Air Act.

(V) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a disabled individual who is eligible for or enrolled in, or has completed a state rehabilitation plan or is a service-connected disabled veteran, veteran of the Vietnam era, or veteran who is recently separated from military service.

(VI) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was an ex-offender. An individual shall be treated as convicted if he or she was placed on probation by a state court without a finding of guilt.

(VII) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a person eligible for or a recipient of any of the following:

(aa) Federal Supplemental Security Income benefits.

(bb) Aid to Families with Dependent Children.

(cc) Food stamps.

(dd) State and local general assistance.

(VIII) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a member of a federally recognized Indian tribe, band, or other group of Native American descent.

(IX) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a resident of a targeted employment area (as defined in Section 7072 of the Government Code).

(X) An employee who qualified the taxpayer for the enterprise zone hiring credit under former Section 23622 or the program area hiring credit under former Section 23623.

(XI) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a member of a targeted group, as defined in Section 51(d) of the Internal Revenue Code, or its successor.

(B) Priority for employment shall be provided to an individual who is enrolled in a qualified program under the federal Job Training Partnership Act or the Greater Avenues for Independence Act of 1985 or who is eligible as a member of a targeted group under the Work Opportunity Tax Credit (Section 51 of the Internal Revenue Code), or its successor.

(5) ''Taxpayer'' means a corporation engaged in a trade or business within an enterprise zone designated pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(6) ''Seasonal employment'' means employment by a taxpayer that has regular and predictable substantial reductions in trade or business operations.

(c) The taxpayer shall do both of the following:

(1) Obtain from either the Employment Development Department, as permitted by federal law, or the local county or city Job Training Partnership Act administrative entity or the local county GAIN office or social services agency, as appropriate, a certification that provides that a qualified employee meets the eligibility requirements specified in clause (iv) of subparagraph

(A) of paragraph (4) of subdivision (b). The Employment Development Department may provide preliminary screening and referral to a certifying agency. The Employment Development Department shall develop a form for this purpose.

(2) Retain a copy of the certification and provide it upon request to the Franchise Tax Board.

(d) (1) For purposes of this section:

(A) All employees of all corporations which are members of the same controlled group of corporations shall be treated as employed by a single taxpayer.

(B) The credit, if any, allowable by this section to each member shall be determined by reference to its proportionate share of the expense of the qualified wages giving rise to the credit, and shall be allocated in that manner.

(C) For purposes of this subdivision, ‘‘controlled group of corporations’’ means ‘‘controlled group of corporations’’ as defined in Section 1563(a) of the Internal Revenue Code, except that:

(i) ‘‘More than 50 percent’’ shall be substituted for ‘‘at least 80 percent’’ each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(ii) The determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of Section 1563 of the Internal Revenue Code.

(2) If an employer acquires the major portion of a trade or business of another employer (hereinafter in this paragraph referred to as the ‘‘predecessor’’) or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section (other than subdivision (e)) for any calendar year ending after that acquisition, the employment relationship between a qualified employee and an employer shall not be treated as terminated if the employee continues to be employed in that trade or business.

(e) (1) (A) If the employment, other than seasonal employment, of any qualified employee with respect to whom qualified wages are taken into account under subdivision (a) is terminated by the taxpayer at any time

during the first 270 days of that employment, whether or not consecutive, or before the close of the 270th calendar day after the day in which that employee completes 90 days of employment with the taxpayer, the tax imposed by this part for the ~~income~~ *taxable* year in which that employment is terminated shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that employee.

(B) If the seasonal employment of any qualified employee, with respect to whom qualified wages are taken into account under subdivision (a) is not continued by the taxpayer for a period of 270 days of employment during the 60-month period beginning with the day the qualified employee commences seasonal employment with the taxpayer, the tax imposed by this part, for the ~~income~~ *taxable* year that includes the 60th month following the month in which the qualified employee commences seasonal employment with the taxpayer, shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that qualified employee.

(2) (A) Subparagraph (A) of paragraph (1) shall not apply to any of the following:

(i) A termination of employment of a qualified employee who voluntarily leaves the employment of the taxpayer.

(ii) A termination of employment of a qualified employee who, before the close of the period referred to in subparagraph (A) of paragraph (1), becomes disabled and unable to perform the services of that employment, unless that disability is removed before the close of that period and the taxpayer fails to offer reemployment to that employee.

(iii) A termination of employment of a qualified employee, if it is determined that the termination was due to the misconduct (as defined in Sections 1256-30 to

1256-43, inclusive, of Title 22 of the California Code of Regulations) of that employee.

(iv) A termination of employment of a qualified employee due to a substantial reduction in the trade or business operations of the taxpayer.

(v) A termination of employment of a qualified employee, if that employee is replaced by other qualified employees so as to create a net increase in both the number of employees and the hours of employment.

(B) Subparagraph (B) of paragraph (1) shall not apply to any of the following:

(i) A failure to continue the seasonal employment of a qualified employee who voluntarily fails to return to the seasonal employment of the taxpayer.

(ii) A failure to continue the seasonal employment of a qualified employee who, before the close of the period referred to in subparagraph (B) of paragraph (1), becomes disabled and unable to perform the services of that seasonal employment, unless that disability is removed before the close of that period and the taxpayer fails to offer seasonal employment to that qualified employee.

(iii) A failure to continue the seasonal employment of a qualified employee, if it is determined that the failure to continue the seasonal employment was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that qualified employee.

(iv) A failure to continue seasonal employment of a qualified employee due to a substantial reduction in the regular seasonal trade or business operations of the taxpayer.

(v) A failure to continue the seasonal employment of a qualified employee, if that qualified employee is replaced by other qualified employees so as to create a net increase in both the number of seasonal employees and the hours of seasonal employment.

(C) For purposes of paragraph (1), the employment relationship between the taxpayer and a qualified

employee shall not be treated as terminated by either of the following:

(i) By a transaction to which Section 381(a) of the Internal Revenue Code applies, if the qualified employee continues to be employed by the acquiring corporation.

(ii) By reason of a mere change in the form of conducting the trade or business of the taxpayer, if the qualified employee continues to be employed in that trade or business and the taxpayer retains a substantial interest in that trade or business.

(3) Any increase in tax under paragraph (1) shall not be treated as tax imposed by this part for purposes of determining the amount of any credit allowable under this part.

(f) Rules similar to the rules provided in Section 46(e) and (h) of the Internal Revenue Code shall apply to both of the following:

(1) An organization to which Section 593 of the Internal Revenue Code applies.

(2) A regulated investment company or a real estate investment trust subject to taxation under this part.

(g) For purposes of this section, ''enterprise zone'' means an area designated as an enterprise zone pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(h) The credit allowable under this section shall be reduced by the credit allowed under Sections 23623.5, 23625, and 23646 claimed for the same employee. The credit shall also be reduced by the federal credit allowed under Section 51 of the Internal Revenue Code.

In addition, any deduction otherwise allowed under this part for the wages or salaries paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit, prior to any reduction required by subdivision (i) or (j).

(i) In the case where the credit otherwise allowed under this section exceeds the ''tax'' for the ~~income~~ *taxable* year, that portion of the credit that exceeds the ''tax'' may be carried over and added to the credit, if any, in succeeding ~~income~~ *taxable* years, until the credit is

exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(j) (1) The amount of the credit otherwise allowed under this section and Section 23612.2, including any credit carryover from prior years, that may reduce the ''tax'' for the ~~income~~ *taxable* year shall not exceed the amount of tax which would be imposed on the taxpayer's business income attributable to the enterprise zone determined as if that attributable income represented all of the income of the taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer's California source business income that is apportioned to the enterprise zone. For that purpose, the taxpayer's business attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the enterprise zone in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Business income shall be apportioned to the enterprise zone by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the enterprise zone during the income year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the income year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the enterprise zone during the income year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the income year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (i).

(k) The changes made to this section by the act adding this subdivision shall apply to ~~income~~ *taxable* years on or after January 1, 1997.

SEC. 79. Section 23622.8 of the Revenue and Taxation Code is amended to read:

23622.8. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1998, there shall be allowed a credit against the ''tax'' (as defined in Section 23036) to a qualified taxpayer for hiring a qualified disadvantaged individual during the ~~income~~ *taxable* year for employment in the Manufacturing Enhancement Area. The credit shall be equal to the sum of each of the following:

(1) Fifty percent of the qualified wages in the first year of employment.

(2) Forty percent of the qualified wages in the second year of employment.

(3) Thirty percent of the qualified wages in the third year of employment.

(4) Twenty percent of the qualified wages in the fourth year of employment.

(5) Ten percent of the qualified wages in the fifth year of employment.

(b) For purposes of this section:

(1) ''Qualified wages'' means:

(A) That portion of wages paid or incurred by the qualified taxpayer during the ~~income~~ *taxable* year to qualified disadvantaged individuals that does not exceed 150 percent of the minimum wage.

(B) The total amount of qualified wages which may be taken into account for purposes of claiming the credit allowed under this section shall not exceed two million dollars ($2,000,000) per ~~income~~ *taxable* year.

(C) Wages received during the 60-month period beginning with the first day the qualified disadvantaged

individual commences employment with the qualified taxpayer. Reemployment in connection with any increase, including a regularly occurring seasonal increase, in the trade or business operations of the qualified taxpayer does not constitute commencement of employment for purposes of this section.

(D) Qualified wages do not include any wages paid or incurred by the qualified taxpayer on or after the Manufacturing Enhancement Area expiration date. However, wages paid or incurred with respect to qualified employees who are employed by the qualified taxpayer within the Manufacturing Enhancement Area within the 60-month period prior to the Manufacturing Enhancement Area expiration date shall continue to qualify for the credit under this section after the Manufacturing Enhancement Area expiration date, in accordance with all provisions of this section applied as if the Manufacturing Enhancement Area designation were still in existence and binding.

(2) ''Minimum wage'' means the wage established by the Industrial Welfare Commission as provided for in Chapter 1 (commencing with Section 1171) of Part 4 of Division 2 of the Labor Code.

(3) ''Manufacturing Enhancement Area'' means an area designated pursuant to Section 7073.8 of the Government Code according to the procedures of Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(4) ''Manufacturing Enhancement Area expiration date'' means the date the Manufacturing Enhancement Area designation expires, is no longer binding, or becomes inoperative.

(5) ''Qualified disadvantaged individual'' means an individual who satisfies all of the following requirements:

(A) (i) At least 90 percent of whose services for the qualified taxpayer during the ~~income~~ *taxable* year are directly related to the conduct of the qualified taxpayer's trade or business located in a Manufacturing Enhancement Area.

(ii) Who performs at least 50 percent of his or her services for the qualified taxpayer during the ~~income~~ *taxable* year in the Manufacturing Enhancement Area.

(B) Who is hired by the qualified taxpayer after the designation of the area as a Manufacturing Enhancement Area in which the individual's services were primarily performed.

(C) Who is any of the following immediately preceding the individual's commencement of employment with the qualified taxpayer:

(i) An individual who has been determined eligible for services under the federal Job Training Partnership Act (29 U.S.C. Sec. 1501 et seq.), or its successor.

(ii) Any voluntary or mandatory registrant under the Greater Avenues for Independence Act of 1985, or its successor, as provided pursuant to Article 3.2 (commencing with Section 11320) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code.

(iii) Any individual who has been certified eligible by the Employment Development Department under the federal Targeted Jobs Tax Credit Program, or its successor, whether or not this program is in effect.

(6) ''Qualified taxpayer'' means any corporation engaged in a trade or business within a Manufacturing Enhancement Area designated pursuant to Section 7073.8 of the Government Code and that meets all of the following requirements:

(A) Is engaged in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(B) At least 50 percent of the qualified taxpayer's work force hired after the designation of the Manufacturing Enhancement Area is composed of individuals who, at the time of hire, are residents of the county in which the Manufacturing Enhancement Area is located.

(C) Of this percentage of local hires, at least 30 percent shall be qualified disadvantaged individuals.

(7) ‘‘Seasonal employment’’ means employment by a qualified taxpayer that has regular and predictable substantial reductions in trade or business operations.

(c) (1) For purposes of this section, all of the following apply:

(A) All employees of all corporations that are members of the same controlled group of corporations shall be treated as employed by a single qualified taxpayer.

(B) The credit (if any) allowable by this section with respect to each member shall be determined by reference to its proportionate share of the expenses of the qualified wages giving rise to the credit and shall be allocated in that manner.

(C) Principles that apply in the case of controlled groups of corporations, as specified in subdivision (d) of Section 23622.7, shall apply with respect to determining employment.

(2) If a qualified taxpayer acquires the major portion of a trade or business of another employer (hereinafter in this paragraph referred to as the ‘‘predecessor’’) or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section (other than subdivision (d)) for any calendar year ending after that acquisition, the employment relationship between a qualified disadvantaged individual and a qualified taxpayer shall not be treated as terminated if the qualified disadvantaged individual continues to be employed in that trade or business.

(d) (1) (A) If the employment, other than seasonal employment, of any qualified disadvantaged individual, with respect to whom qualified wages are taken into account under subdivision (b) is terminated by the qualified taxpayer at any time during the first 270 days of that employment (whether or not consecutive) or before the close of the 270th calendar day after the day in which that qualified disadvantaged individual completes 90 days of employment with the qualified taxpayer, the tax imposed by this part for the ~~income~~ *taxable* year in which that employment is terminated shall be increased by an

amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that qualified disadvantaged individual.

(B) If the seasonal employment of any qualified disadvantaged individual, with respect to whom qualified wages are taken into account under subdivision (a) is not continued by the qualified taxpayer for a period of 270 days of employment during the 60-month period beginning with the day the qualified disadvantaged individual commences seasonal employment with the qualified taxpayer, the tax imposed by this part, for the ~~income~~ *taxable* year that includes the 60th month following the month in which the qualified disadvantaged individual commences seasonal employment with the qualified taxpayer, shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that qualified disadvantaged individual.

(2) (A) Subparagraph (A) of paragraph (1) does not apply to any of the following:

(i) A termination of employment of a qualified disadvantaged individual who voluntarily leaves the employment of the qualified taxpayer.

(ii) A termination of employment of a qualified disadvantaged individual who, before the close of the period referred to in subparagraph (A) of paragraph (1), becomes disabled to perform the services of that employment, unless that disability is removed before the close of that period and the qualified taxpayer fails to offer reemployment to that individual.

(iii) A termination of employment of a qualified disadvantaged individual, if it is determined that the termination was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that individual.

(iv) A termination of employment of a qualified disadvantaged individual due to a substantial reduction in the trade or business operations of the qualified taxpayer.

(v) A termination of employment of a qualified disadvantaged individual, if that individual is replaced by other qualified disadvantaged individuals so as to create a net increase in both the number of employees and the hours of employment.

(B) Subparagraph (B) of paragraph (1) shall not apply to any of the following:

(i) A failure to continue the seasonal employment of a qualified disadvantaged individual who voluntarily fails to return to the seasonal employment of the qualified taxpayer.

(ii) A failure to continue the seasonal employment of a qualified disadvantaged individual who, before the close of the period referred to in subparagraph (B) of paragraph (1), becomes disabled and unable to perform the services of that seasonal employment, unless that disability is removed before the close of that period and the qualified taxpayer fails to offer seasonal employment to that qualified disadvantaged individual.

(iii) A failure to continue the seasonal employment of a qualified disadvantaged individual, if it is determined that the failure to continue the seasonal employment was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that qualified disadvantaged individual.

(iv) A failure to continue seasonal employment of a qualified disadvantaged individual due to a substantial reduction in the regular seasonal trade or business operations of the qualified taxpayer.

(v) A failure to continue the seasonal employment of a qualified disadvantaged individual, if that qualified disadvantaged individual is replaced by other qualified disadvantaged individuals so as to create a net increase in both the number of seasonal employees and the hours of seasonal employment.

(C) For purposes of paragraph (1), the employment relationship between the qualified taxpayer and a qualified disadvantaged individual shall not be treated as terminated by either of the following:

(i) By a transaction to which Section 381(a) of the Internal Revenue Code applies, if the qualified disadvantaged individual continues to be employed by the acquiring corporation.

(ii) By reason of a mere change in the form of conducting the trade or business of the qualified taxpayer, if the qualified disadvantaged individual continues to be employed in that trade or business and the qualified taxpayer retains a substantial interest in that trade or business.

(3) Any increase in tax under paragraph (1) shall not be treated as tax imposed by this part for purposes of determining the amount of any credit allowable under this part.

(e) The credit shall be reduced by the credit allowed under Section 23621. The credit shall also be reduced by the federal credit allowed under Section 51 of the Internal Revenue Code.

In addition, any deduction otherwise allowed under this part for the wages or salaries paid or incurred by the qualified taxpayer upon which the credit is based shall be reduced by the amount of the credit, prior to any reduction required by subdivision (f) or (g).

(f) In the case where the credit otherwise allowed under this section exceeds the ''tax'' for the ~~income~~ *taxable* year, that portion of the credit that exceeds the ''tax'' may be carried over and added to the credit, if any, in succeeding years, until the credit is exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(g) (1) The amount of credit otherwise allowed under this section, including prior year credit carryovers, that may reduce the ''tax'' for the ~~income~~ *taxable* year shall not exceed the amount of tax that would be imposed on the qualified taxpayer's business income attributed to a Manufacturing Enhancement Area determined as if that attributed income represented all of the net income of the qualified taxpayer subject to tax under this part.

(2) Attributable income is that portion of the taxpayer's California source business income that is

apportioned to the Manufacturing Enhancement Area. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the Manufacturing Enhancement Area in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Income shall be apportioned to a Manufacturing Enhancement Area by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For the purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the Manufacturing Enhancement Area during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the Manufacturing Enhancement Area during the taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the taxable year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (g).

(h) If the taxpayer is allowed a credit pursuant to this section for qualified wages paid or incurred, only one credit shall be allowed to the taxpayer under this part with respect to any wage consisting in whole or in part of those qualified wages.

SEC. 80. Section 23624 of the Revenue and Taxation Code is amended to read:

23624. (a) There shall be allowed as a credit against the ''tax'' (as defined by Section 23036) an amount equal to 10 percent of the amount of wages paid or incurred during the ~~income~~ *taxable* year to each prisoner who is employed in a joint venture program established pursuant to Article 1.5 of Chapter 5 of Title 1 of Part 3 of the Penal Code, through agreement with the Director of Corrections.

(b) The Department of Corrections shall forward annually to the Franchise Tax Board a list of all employers certified by the Department of Corrections as active participants in a joint venture program pursuant to Article 1.5 (commencing with Section 2717.1) of Chapter 5 of Title 1 of Part 3 of the Penal Code. The list shall include the certified participant's federal employer identification number.

SEC. 81. Section 23633 of the Revenue and Taxation Code is amended to read:

23633. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1998, there shall be allowed as a credit against the ''tax'' (as defined by Section 23036) for the ~~income~~ *taxable* year an amount equal to the sales or use tax paid or incurred during the ~~income~~ *taxable* year by the qualified taxpayer in connection with the qualified taxpayer's purchase of qualified property.

(b) For purposes of this section:

(1) ''Qualified property'' means property that meets all of the following requirements:

(A) Is any of the following:

(i) Machinery and machinery parts used for fabricating, processing, assembling, and manufacturing.

(ii) Machinery and machinery parts used for the production of renewable energy resources.

(iii) Machinery and machinery parts used for either of the following:

(I) Air pollution control mechanisms.

(II) Water pollution control mechanisms.

(iv) Data processing and communications equipment, such as computers, computer-automated drafting systems, copy machines, telephone systems, and faxes.

(v) Motion picture manufacturing equipment central to production and post production, such as cameras, audio recorders, and digital image and sound processing equipment.

(B) The total cost of qualified property purchased and placed in service in any ~~income~~ *taxable* year that may be taken into account by any qualified taxpayer for purposes of claiming this credit shall not exceed twenty million dollars ($20,000,000).

(C) The qualified property is used by the qualified taxpayer exclusively in a targeted tax area.

(D) The qualified property is purchased and placed in service before the date the targeted tax area designation expires, is revoked, is no longer binding, or becomes inoperative.

(2) (A) ‘‘Qualified taxpayer’’ means a corporation that meets both of the following:

(i) Is engaged in a trade or business within a targeted tax area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(ii) Is engaged in those lines of business described in Codes 2000 to 2099, inclusive; 2200 to 3999, inclusive; 4200 to 4299, inclusive; 4500 to 4599, inclusive; and 4700 to 5199, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(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 17053.33 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 10 (commencing with Section 17001). For purposes of this subparagraph, the term ‘‘pass-through entity’’ means any partnership or S corporation.

(3) ‘‘Targeted tax area’’ means the area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(c) If the qualified taxpayer is allowed a credit for qualified property pursuant to this section, only one credit shall be allowed to the taxpayer under this part with respect to that qualified property.

(d) If the qualified taxpayer has purchased property upon which a use tax has been paid or incurred, the credit provided by this section shall be allowed only if qualified property of a comparable quality and price is not timely available for purchase in this state.

(e) In the case where the credit otherwise allowed under this section exceeds the ‘‘tax’’ for the ~~income~~ *taxable* year, that portion of the credit that exceeds the ‘‘tax’’ may be carried over and added to the credit, if any, in the following year, and succeeding years if necessary, until the credit is exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(f) Any qualified taxpayer who elects to be subject to this section shall not be entitled to increase the basis of the qualified property as otherwise required by Section 164(a) of the Internal Revenue Code with respect to sales or use tax paid or incurred in connection with the qualified taxpayer’s purchase of qualified property.

(g) (1) The amount of credit otherwise allowed under this section and Section 23634, including any credit carryover from prior years, that may reduce the ‘‘tax’’ for the ~~income~~ *taxable* year shall not exceed the amount of tax that would be imposed on the qualified taxpayer’s business income attributable to the targeted tax area determined as if that attributable income represented all of the income of the qualified taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer’s California source business income that is apportioned to the targeted tax area. For that purpose, the taxpayer’s business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That

business income shall be further apportioned to the targeted tax area in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Business income shall be apportioned to the targeted tax area by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the targeted tax area during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the targeted tax area during the taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the taxable year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (e).

(5) In the event that a credit carryover is allowable under subdivision (e) for any ~~income~~ *taxable* year after the targeted tax area designation has expired, has been revoked, is no longer binding, or has become inoperative, the targeted tax area shall be deemed to remain in existence for purposes of computing the limitation specified in this subdivision.

(h) The changes made to this section by the act adding this subdivision shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1998.

SEC. 82. Section 23634 of the Revenue and Taxation Code is amended to read:

23634. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1998, there shall be allowed a credit against the ''tax'' (as defined by Section 23036) to a qualified taxpayer who employs a qualified employee in a targeted tax area during the ~~income~~ *taxable* year. The credit shall be equal to the sum of each of the following:

(1) Fifty percent of qualified wages in the first year of employment.

(2) Forty percent of qualified wages in the second year of employment.

(3) Thirty percent of qualified wages in the third year of employment.

(4) Twenty percent of qualified wages in the fourth year of employment.

(5) Ten percent of qualified wages in the fifth year of employment.

(b) For purposes of this section:

(1) ''Qualified wages'' means:

(A) That portion of wages paid or incurred by the qualified taxpayer during the ~~income~~ *taxable* year to qualified employees that does not exceed 150 percent of the minimum wage.

(B) Wages received during the 60-month period beginning with the first day the employee commences employment with the qualified taxpayer. Reemployment in connection with any increase, including a regularly occurring seasonal increase, in the trade or business operations of the qualified taxpayer does not constitute commencement of employment for purposes of this section.

(C) Qualified wages do not include any wages paid or incurred by the qualified taxpayer on or after the targeted tax area expiration date. However, wages paid or incurred with respect to qualified employees who are employed by the qualified taxpayer within the targeted tax area within the 60-month period prior to the targeted tax area expiration date shall continue to qualify for the credit under this section after the targeted tax area

expiration date, in accordance with all provisions of this section applied as if the targeted tax area designation were still in existence and binding.

(2) ‘‘Minimum wage’’ means the wage established by the Industrial Welfare Commission as provided for in Chapter 1 (commencing with Section 1171) of Part 4 of Division 2 of the Labor Code.

(3) ‘‘Targeted tax area expiration date’’ means the date the targeted tax area designation expires, is revoked, is no longer binding, or becomes inoperative.

(4) (A) ‘‘Qualified employee’’ means an individual who meets all of the following requirements:

(i) At least 90 percent of his or her services for the qualified taxpayer during the ~~income~~ *taxable* year are directly related to the conduct of the qualified taxpayer’s trade or business located in a targeted tax area.

(ii) Performs at least 50 percent of his or her services for the qualified taxpayer during the ~~income~~ *taxable* year in a targeted tax area.

(iii) Is hired by the qualified taxpayer after the date of original designation of the area in which services were performed as a targeted tax area.

(iv) Is any of the following:

(I) Immediately preceding the qualified employee’s commencement of employment with the qualified taxpayer, was a person eligible for services under the federal Job Training Partnership Act (29 U.S.C. Sec. 1501 et seq.), or its successor, who is receiving, or is eligible to receive, subsidized employment, training, or services funded by the federal Job Training Partnership Act, or its successor.

(II) Immediately preceding the qualified employee’s commencement of employment with the qualified taxpayer, was a person eligible to be a voluntary or mandatory registrant under the Greater Avenues for Independence Act of 1985 (GAIN) provided for pursuant to Article 3.2 (commencing with Section 11320) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code, or its successor.

(III) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was an economically disadvantaged individual 14 years of age or older.

(IV) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was a dislocated worker who meets any of the following:

(aa) Has been terminated or laid off or who has received a notice of termination or layoff from employment, is eligible for or has exhausted entitlement to unemployment insurance benefits, and is unlikely to return to his or her previous industry or occupation.

(bb) Has been terminated or has received a notice of termination of employment as a result of any permanent closure or any substantial layoff at a plant, facility, or enterprise, including an individual who has not received written notification but whose employer has made a public announcement of the closure or layoff.

(cc) Is long-term unemployed and has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the individual resides, including an individual 55 years of age or older who may have substantial barriers to employment by reason of age.

(dd) Was self-employed (including farmers and ranchers) and is unemployed as a result of general economic conditions in the community in which he or she resides or because of natural disasters.

(ee) Was a civilian employee of the Department of Defense employed at a military installation being closed or realigned under the Defense Base Closure and Realignment Act of 1990.

(ff) Was an active member of the armed forces or National Guard as of September 30, 1990, and was either involuntarily separated or separated pursuant to a special benefits program.

(gg) Is a seasonal or migrant worker who experiences chronic seasonal unemployment and underemployment

in the agriculture industry, aggravated by continual advancements in technology and mechanization.

(hh) Has been terminated or laid off, or has received a notice of termination or layoff, as a consequence of compliance with the Clean Air Act.

(V) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was a disabled individual who is eligible for or enrolled in, or has completed a state rehabilitation plan or is a service-connected disabled veteran, veteran of the Vietnam era, or veteran who is recently separated from military service.

(VI) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was an ex-offender. An individual shall be treated as convicted if he or she was placed on probation by a state court without a finding of guilt.

(VII) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was a person eligible for or a recipient of any of the following:

(aa) Federal Supplemental Security Income benefits.

(bb) Aid to Families with Dependent Children.

(cc) Food stamps.

(dd) State and local general assistance.

(VIII) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was a member of a federally recognized Indian tribe, band, or other group of Native American descent.

(IX) Immediately preceding the qualified employee's commencement of employment with the qualified taxpayer, was a resident of a targeted tax area.

(X) Immediately preceding the qualified employee's commencement of employment with the taxpayer, was a member of a targeted group, as defined in Section 51(d) of the Internal Revenue Code, or its successor.

(B) Priority for employment shall be provided to an individual who is enrolled in a qualified program under the federal Job Training Partnership Act or the Greater

Avenues for Independence Act of 1985 or who is eligible as a member of a targeted group under the Work Opportunity Tax Credit (Section 51 of the Internal Revenue Code), or its successor.

(5) (A) ‘‘Qualified taxpayer’’ means a person or entity that meets both of the following:

(i) Is engaged in a trade or business within a targeted tax area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(ii) Is engaged in those lines of business described in Codes 2000 to 2099, inclusive; 2200 to 3999, inclusive; 4200 to 4299, inclusive; 4500 to 4599, inclusive; and 4700 to 5199, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(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 17053.34 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 10 (commencing with Section 17001). For purposes of this subparagraph, the term ‘‘pass-through entity’’ means any partnership or S corporation.

(6) ‘‘Seasonal employment’’ means employment by a qualified taxpayer that has regular and predictable substantial reductions in trade or business operations.

(c) If the qualified taxpayer is allowed a credit for qualified wages pursuant to this section, only one credit shall be allowed to the taxpayer under this part with respect to those qualified wages.

(d) The qualified taxpayer shall do both of the following:

(1) Obtain from either the Employment Development Department, as permitted by federal law, or the local county or city Job Training Partnership Act administrative entity or the local county GAIN office or social services agency, as appropriate, a certification that

provides that a qualified employee meets the eligibility requirements specified in clause (iv) of subparagraph (A) of paragraph (4) of subdivision (b). The Employment Development Department may provide preliminary screening and referral to a certifying agency. The Employment Development Department shall develop a form for this purpose.

(2) Retain a copy of the certification and provide it upon request to the Franchise Tax Board.

(e) (1) For purposes of this section:

(A) All employees of all corporations that are members of the same controlled group of corporations shall be treated as employed by a single taxpayer.

(B) The credit, if any, allowable by this section to each member shall be determined by reference to its proportionate share of the expense of the qualified wages giving rise to the credit, and shall be allocated in that manner.

(C) For purposes of this subdivision, ‘‘controlled group of corporations’’ means ‘‘controlled group of corporations’’ as defined in Section 1563(a) of the Internal Revenue Code, except that:

(i) ‘‘More than 50 percent’’ shall be substituted for ‘‘at least 80 percent’’ each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(ii) The determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of Section 1563 of the Internal Revenue Code.

(2) If an employer acquires the major portion of a trade or business of another employer (hereinafter in this paragraph referred to as the ‘‘predecessor’’) or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section (other than subdivision (f)) for any calendar year ending after that acquisition, the employment relationship between a qualified employee and an employer shall not be treated as terminated if the employee continues to be employed in that trade or business.

(f) (1) (A) If the employment, other than seasonal employment, of any qualified employee with respect to

whom qualified wages are taken into account under subdivision (a) is terminated by the qualified taxpayer at any time during the first 270 days of that employment (whether or not consecutive) or before the close of the 270th calendar day after the day in which that employee completes 90 days of employment with the qualified taxpayer, the tax imposed by this part for the ~~income~~ *taxable* year in which that employment is terminated shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that employee.

(B) If the seasonal employment of any qualified employee, with respect to whom qualified wages are taken into account under subdivision (a) is not continued by the qualified taxpayer for a period of 270 days of employment during the 60-month period beginning with the day the qualified employee commences seasonal employment with the qualified taxpayer, the tax imposed by this part, for the ~~income~~ *taxable* year that includes the 60th month following the month in which the qualified employee commences seasonal employment with the qualified taxpayer, shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that qualified employee.

(2) (A) Subparagraph (A) of paragraph (1) shall not apply to any of the following:

(i) A termination of employment of a qualified employee who voluntarily leaves the employment of the qualified taxpayer.

(ii) A termination of employment of a qualified employee who, before the close of the period referred to in subparagraph (A) of paragraph (1), becomes disabled and unable to perform the services of that employment, unless that disability is removed before the close of that period and the qualified taxpayer fails to offer reemployment to that employee.

(iii) A termination of employment of a qualified employee, if it is determined that the termination was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that employee.

(iv) A termination of employment of a qualified employee due to a substantial reduction in the trade or business operations of the taxpayer.

(v) A termination of employment of a qualified employee, if that employee is replaced by other qualified employees so as to create a net increase in both the number of employees and the hours of employment.

(B) Subparagraph (B) of paragraph (1) shall not apply to any of the following:

(i) A failure to continue the seasonal employment of a qualified employee who voluntarily fails to return to the seasonal employment of the qualified taxpayer.

(ii) A failure to continue the seasonal employment of a qualified employee who, before the close of the period referred to in subparagraph (B) of paragraph (1), becomes disabled and unable to perform the services of that seasonal employment, unless that disability is removed before the close of that period and the qualified taxpayer fails to offer seasonal employment to that qualified employee.

(iii) A failure to continue the seasonal employment of a qualified employee, if it is determined that the failure to continue the seasonal employment was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that qualified employee.

(iv) A failure to continue seasonal employment of a qualified employee due to a substantial reduction in the regular seasonal trade or business operations of the qualified taxpayer.

(v) A failure to continue the seasonal employment of a qualified employee, if that qualified employee is replaced by other qualified employees so as to create a net increase in both the number of seasonal employees and the hours of seasonal employment.

(C) For purposes of paragraph (1), the employment relationship between the qualified taxpayer and a qualified employee shall not be treated as terminated by either of the following:

(i) By a transaction to which Section 381(a) of the Internal Revenue Code applies, if the qualified employee continues to be employed by the acquiring corporation.

(ii) By reason of a mere change in the form of conducting the trade or business of the qualified taxpayer, if the qualified employee continues to be employed in that trade or business and the qualified taxpayer retains a substantial interest in that trade or business.

(3) Any increase in tax under paragraph (1) shall not be treated as tax imposed by this part for purposes of determining the amount of any credit allowable under this part.

(g) Rules similar to the rules provided in Sections 46(e) and (h) of the Internal Revenue Code shall apply to both of the following:

(1) An organization to which Section 593 of the Internal Revenue Code applies.

(2) A regulated investment company or a real estate investment trust subject to taxation under this part.

(h) For purposes of this section, ''targeted tax area'' means an area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(i) In the case where the credit otherwise allowed under this section exceeds the ''tax'' for the ~~income~~ *taxable* year, that portion of the credit that exceeds the ''tax'' may be carried over and added to the credit, if any, in succeeding ~~income~~ *taxable* years, until the credit is exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(j) (1) The amount of the credit otherwise allowed under this section and Section 23633, including any credit carryover from prior years, that may reduce the ''tax'' for the ~~income~~ *taxable* year shall not exceed the amount of tax that would be imposed on the qualified taxpayer's

business income attributable to the targeted tax area determined as if that attributable income represented all of the income of the qualified taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer's California source business income that is apportioned to the targeted tax area. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the targeted tax area in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Business income shall be apportioned to the targeted tax area by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the targeted tax area during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the targeted tax area during the taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the taxable year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (h).

(5) In the event that a credit carryover is allowable under subdivision (h) for any ~~income~~ *taxable* year after the targeted tax area designation has expired or been revoked, the targeted tax area shall be deemed to remain in existence for purposes of computing the limitation specified in this subdivision.

SEC. 83. Section 23636 of the Revenue and Taxation Code is amended to read:

23636. (a) For each ~~income~~ *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 ''tax,'' as defined in Section 23036, an amount equal to the following:

(1) Fifty percent of qualified wages paid or incurred during any ~~income~~ *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 ~~income~~ *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 ~~income~~ *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 ~~income~~ *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 ~~income~~ *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 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~~ *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 ~~an income~~ *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 ~~income~~ *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 ‘‘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. 84. Section 23637 of the Revenue and Taxation Code is amended to read:

23637. (a) For each ~~income~~ *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 ''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~~ *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 ~~income~~ *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 tax of the qualified taxpayer for the ~~income~~ *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 ''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. 85. Section 23642 of the Revenue and Taxation Code is amended to read:

23642. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1996, there shall be allowed as a credit against the ''tax,'' as defined in Section 23036, the amount paid or incurred for eligible access expenditures. The credit shall be allowed in accordance with Section 44 of the Internal Revenue Code, relating to expenditures to provide access to disabled individuals, except that the credit amount specified in subdivision (b) shall be substituted for the credit amount specified in Section 44(a) of the Internal Revenue Code.

(b) The credit amount allowed under this section shall be 50 percent of so much of the eligible access expenditures for the ~~income~~ *taxable* year as do not exceed two hundred fifty dollars ($250).

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

SEC. 86. Section 23645 of the Revenue and Taxation Code is amended to read:

23645. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1995, there shall be allowed as a credit against the ''tax'' (as defined by Section 23036) for the ~~income~~ *taxable* year an amount equal to the sales or use tax paid or incurred by the taxpayer in connection with the purchase of qualified property to the extent that the qualified property does not exceed a value of twenty million dollars ($20,000,000).

(b) For purposes of this section:

(1) ''LAMBRA'' means a local agency military base recovery area designated in accordance with Section 7114 of the Government Code.

(2) ''Taxpayer'' means a corporation that conducts a trade or business within a LAMBRA and, for the first two ~~income~~ *taxable* years, has a net increase in jobs (defined

as 2,000 paid hours per employee per year) of one or more employees in the LAMBRA.

(A) The net increase in the number of jobs shall be determined by subtracting the total number of full-time employees (defined as 2,000 paid hours per employee per year) the taxpayer employed in this state in the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA from the total number of full-time employees the taxpayer employed in this state during the second ~~income~~ *taxable* year after commencing business operations in the LAMBRA. For taxpayers who commence doing business in this state with their LAMBRA business operation, the number of employees for the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA shall be zero. If the taxpayer has a net increase in jobs in the state, the credit shall be allowed only if one or more full-time employees is employed within the LAMBRA.

(B) The total number of employees employed in the LAMBRA shall equal the sum of both of the following:

(i) The total number of hours worked in the LAMBRA for the taxpayer by employees (not to exceed 2,000 hours per employee) who are paid an hourly wage divided by 2,000.

(ii) The total number of months worked in the LAMBRA for the taxpayer by employees that are salaried employees divided by 12.

(C) In the case of a taxpayer who first commences doing business in the LAMBRA during the ~~income~~ *taxable* year, for purposes of clauses (i) and (ii), respectively, of subparagraph (B) the divisors ‘‘2,000’’ and ‘‘12’’ shall be multiplied by a fraction, the numerator of which is the number of months of the ~~income~~ *taxable* year that the taxpayer was doing business in the LAMBRA and the denominator of which is 12.

(3) ‘‘Qualified property’’ means property that is each of the following:

(A) Purchased by the taxpayer for exclusive use in a trade or business conducted within a LAMBRA.

(B) Purchased before the date the LAMBRA designation expires, is no longer binding, or becomes inoperative.

(C) Any of the following:

(i) High technology equipment, including, but not limited to, computers and electronic processing equipment.

(ii) Aircraft maintenance equipment, including, but not limited to, engine stands, hydraulic mules, power carts, test equipment, handtools, aircraft start carts, and tugs.

(iii) Aircraft components, including, but not limited to, engines, fuel control units, hydraulic pumps, avionics, starts, wheels, and tires.

(iv) Section 1245 property, as defined in Section 1245(a)(3) of the Internal Revenue Code.

(c) The credit provided under subdivision (a) shall only be allowed for qualified property manufactured in California unless qualified property of a comparable quality and price is not available for timely purchase and delivery from a California manufacturer.

(d) In the case where the credit otherwise allowed under this section exceeds the ''tax'' for the ~~income~~ *taxable* year, that portion of the credit which exceeds the ''tax'' may be carried over and added to the credit, if any, in succeeding years, until the credit is exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(e) Any taxpayer who elects to be subject to this section shall not be entitled to increase the basis of the property as otherwise required by Section 164(a) of the Internal Revenue Code with respect to sales or use tax paid or incurred in connection with the purchase of qualified property.

(f) (1) The amount of the credit otherwise allowed under this section and Section 23646, including any credit carryovers from prior years, that may reduce the ''tax'' for the ~~income~~ *taxable* year shall not exceed the amount of tax that would be imposed on the taxpayer's business income attributed to a LAMBRA determined as if that

attributable income represented all the income of the taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer's California source business income that is apportioned to the LAMBRA. For that purpose, the taxpayer's business income that is attributable to sources in this state shall first be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the LAMBRA in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Income shall be apportioned to a LAMBRA by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor, plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the LAMBRA during the ~~income~~ *taxable* year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the LAMBRA during the ~~income~~ *taxable* year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ *taxable* year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (d).

(g) (1) If the qualified property is disposed of or no longer used by the taxpayer in the LAMBRA, at any time before the close of the second income year after the

property is placed in service, the amount of the credit previously claimed, with respect to that property, shall be added to the taxpayer's tax liability in the income year of that disposition or nonuse.

(2) At the close of the second ~~income~~ *taxable* year, if the taxpayer has not increased the number of its employees as determined by paragraph (2) of subdivision (b), then the amount of the credit previously claimed shall be added to the taxpayer's tax for the taxpayer's second ~~income~~ *taxable* year.

(h) If the taxpayer is allowed a credit for qualified property pursuant to this section, only one credit shall be allowed to the taxpayer under this part with respect to that qualified property.

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

SEC. 87. Section 23646 of the Revenue and Taxation Code is amended to read:

23646. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1995, there shall be allowed as a credit against the ''tax'' (as defined in Section 23036) to a qualified taxpayer for hiring a qualified disadvantaged individual or a qualified displaced employee during the ~~income~~ *taxable* year for employment in the LAMBRA. The credit shall be equal to the sum of each of the following:

(1) Fifty percent of the qualified wages in the first year of employment.

(2) Forty percent of the qualified wages in the second year of employment.

(3) Thirty percent of the qualified wages in the third year of employment.

(4) Twenty percent of the qualified wages in the fourth year of employment.

(5) Ten percent of the qualified wages in the fifth year of employment.

(b) For purposes of this section:

(1) ''Qualified wages'' means:

(A) That portion of wages paid or incurred by the employer during the ~~income~~ *taxable* year to qualified disadvantaged individuals or qualified displaced employees that does not exceed 150 percent of the minimum wage.

(B) The total amount of qualified wages which may be taken into account for purposes of claiming the credit allowed under this section shall not exceed two million dollars ($2,000,000) per ~~income~~ *taxable* year.

(C) Wages received during the 60-month period beginning with the first day the individual commences employment with the taxpayer. Reemployment in connection with any increase, including a regularly occurring seasonal increase, in the trade or business operation of the qualified taxpayer does not constitute commencement of employment for purposes of this section.

(D) Qualified wages do not include any wages paid or incurred by the qualified taxpayer on or after the LAMBRA expiration date. However, wages paid or incurred with respect to qualified disadvantaged individuals or qualified displaced employees who are employed by the qualified taxpayer within the LAMBRA within the 60-month period prior to the LAMBRA expiration date shall continue to qualify for the credit under this section after the LAMBRA expiration date, in accordance with all provisions of this section applied as if the LAMBRA designation were still in existence and binding.

(2) ''Minimum wage'' means the wage established by the Industrial Welfare Commission as provided for in Chapter 1 (commencing with Section 1171) of Part 4 of Division 2 of the Labor Code.

(3) ''LAMBRA'' means a local agency military base recovery area designated in accordance with the provisions of Section 7114 of the Government Code.

(4) ''Qualified disadvantaged individual'' means an individual who satisfies all of the following requirements:

(A) (i) At least 90 percent of whose services for the taxpayer during the ~~income~~ *taxable* year are directly

related to the conduct of the taxpayer's trade or business located in a LAMBRA.

(ii) Who performs at least 50 percent of his or her services for the taxpayer during the ~~income~~ *taxable* year in the LAMBRA.

(B) Who is hired by the employer after the designation of the area as a LAMBRA in which the individual's services were primarily performed.

(C) Who is any of the following immediately preceding the individual's commencement of employment with the taxpayer:

(i) An individual who has been determined eligible for services under the federal Job Training Partnership Act (29 U.S.C. Sec. 1501 et seq.).

(ii) Any voluntary or mandatory registrant under the Greater Avenues for Independence Act of 1985 provided for pursuant to Article 3.2 (commencing with Section 11320) of Chapter 2 of Part 3 of Division 9 of the Welfare and Institutions Code.

(iii) An economically disadvantaged individual age 16 years or older.

(iv) A dislocated worker who meets any of the following conditions:

(I) Has been terminated or laid off or who has received a notice of termination or layoff from employment, is eligible for or has exhausted entitlement to unemployment insurance benefits, and is unlikely to return to his or her previous industry or occupation.

(II) Has been terminated or has received a notice of termination of employment as a result of any permanent closure or any substantial layoff at a plant, facility, or enterprise, including an individual who has not received written notification but whose employer has made a public announcement of such a closure or layoff.

(III) Is long-term unemployed and has limited opportunities for employment or reemployment in the same or a similar occupation in the area in which the individual resides, including an individual 55 years of age or older who may have substantial barriers to employment by reason of age.

(IV) Was self-employed (including farmers and ranchers) and is unemployed as a result of general economic conditions in the community in which he or she resides or because of natural disasters.

(V) Was a civilian employee of the Department of Defense employed at a military installation being closed or realigned under the Defense Base Closure and Realignment Act of 1990.

(VI) Was an active member of the armed forces or National Guard as of September 30, 1990, and was either involuntarily separated or separated pursuant to a special benefits program.

(VII) Experiences chronic seasonal unemployment and underemployment in the agriculture industry, aggravated by continual advancements in technology and mechanization.

(VIII) Has been terminated or laid off or has received a notice of termination or layoff as a consequence of compliance with the Clean Air Act.

(v) An individual who is enrolled in or has completed a state rehabilitation plan or is a service-connected disabled veteran, veteran of the Vietnam era, or veteran who is recently separated from military service.

(vi) An ex-offender. An individual shall be treated as convicted if he or she was placed on probation by a state court without a finding of guilty.

(vii) A recipient of:

(I) Federal Supplemental Security Income benefits.

(II) Aid to Families with Dependent Children.

(III) Food stamps.

(IV) State and local general assistance.

(viii) Is a member of a federally recognized Indian tribe, band, or other group of Native American descent.

(5) ‘‘Qualified taxpayer’’ means a corporation that conducts a trade or business within a LAMBRA and, for the first two ~~income~~ *taxable* years, has a net increase in jobs (defined as 2,000 paid hours per employee per year) of one or more employees as determined below in the LAMBRA.

(A) The net increase in the number of jobs shall be determined by subtracting the total number of full-time employees (defined as 2,000 paid hours per employee per year) the taxpayer employed in this state in the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA from the total number of full-time employees the taxpayer employed in this state during the second ~~income~~ *taxable* year after commencing business operations in the LAMBRA. For taxpayers who commence doing business in this state with their LAMBRA business operation, the number of employees for the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA shall be zero. If the taxpayer has a net increase in jobs in the state, the credit shall be allowed only if one or more full-time employees is employed within the LAMBRA.

(B) The total number of employees employed in the LAMBRA shall equal the sum of both of the following:

(i) The total number of hours worked in the LAMBRA for the taxpayer by employees (not to exceed 2,000 hours per employee) who are paid an hourly wage divided by 2,000.

(ii) The total number of months worked in the LAMBRA for the taxpayer by employees who are salaried employees divided by 12.

(C) In the case of a qualified taxpayer that first commences doing business in the LAMBRA during the ~~income~~ *taxable* year, for purposes of clauses (i) and (ii), respectively, of subparagraph (B) the divisors ‘‘2,000’’ and ‘‘12’’ shall be multiplied by a fraction, the numerator of which is the number of months of the ~~income~~ *taxable* year that the taxpayer was doing business in the LAMBRA and the denominator of which is 12.

(6) ‘‘Qualified displaced employee’’ means an individual who satisfies all of the following requirements:

(A) Any civilian or military employee of a base or former base that has been displaced as a result of a federal base closure act.

(B) (i) At least 90 percent of whose services for the taxpayer during the ~~income~~ *taxable* year are directly

related to the conduct of the taxpayer's trade or business located in a LAMBRA.

(ii) Who performs at least 50 percent of his or her services for the taxpayer during the ~~income~~ *taxable* year in a LAMBRA.

(C) Who is hired by the employer after the designation of the area in which services were performed as a LAMBRA.

(7) ''Seasonal employment'' means employment by a qualified taxpayer that has regular and predictable substantial reductions in trade or business operations.

(8) ''LAMBRA expiration date'' means the date the LAMBRA designation expires, is no longer binding, or becomes inoperative.

(c) (1) For purposes of this section, both of the following apply:

(A) All employees of all corporations that are members of the same controlled group of corporations shall be treated as employed by a single employer.

(B) The credit (if any) allowable by this section to each member shall be determined by reference to its proportionate share of the qualified wages giving rise to the credit.

(2) For purposes of this subdivision, ''controlled group of corporations'' has the meaning given to that term by Section 1563(a) of the Internal Revenue Code, except that both of the following apply:

(A) ''More than 50 percent'' shall be substituted for ''at least 80 percent'' each place it appears in Section 1563(a)(1) of the Internal Revenue Code.

(B) The determination shall be made without regard to Section 1563(a)(4) and Section 1563(e)(3)(C) of the Internal Revenue Code.

(3) If an employer acquires the major portion of a trade or business of another employer (hereinafter in this paragraph referred to as the ''predecessor'') or the major portion of a separate unit of a trade or business of a predecessor, then, for purposes of applying this section (other than subdivision (d)) for any calendar year ending after that acquisition, the employment relationship

between an employee and an employer shall not be treated as terminated if the employee continues to be employed in that trade or business.

(d) (1) (A) If the employment of any employee, other than seasonal employment, with respect to whom qualified wages are taken into account under subdivision (a) is terminated by the taxpayer at any time during the first 270 days of that employment (whether or not consecutive) or before the close of the 270th calendar day after the day in which that employee completes 90 days of employment with the taxpayer, the tax imposed by this part for the ~~income~~ *taxable* year in which that employment is terminated shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that employee.

(B) If the seasonal employment of any qualified disadvantaged individual, with respect to whom qualified wages are taken into account under subdivision (a) is not continued by the qualified taxpayer for a period of 270 days of employment during the 60-month period beginning with the day the qualified disadvantaged individual commences seasonal employment with the qualified taxpayer, the tax imposed by this part, for the ~~income~~ *taxable* year that includes the 60th month following the month in which the qualified disadvantaged individual commences seasonal employment with the qualified taxpayer, shall be increased by an amount equal to the credit allowed under subdivision (a) for that ~~income~~ *taxable* year and all prior ~~income~~ *taxable* years attributable to qualified wages paid or incurred with respect to that qualified disadvantaged individual.

(2) (A) Subparagraph (A) of paragraph (1) shall not apply to any of the following:

(i) A termination of employment of an employee who voluntarily leaves the employment of the taxpayer.

(ii) A termination of employment of an individual who, before the close of the period referred to in paragraph (1), becomes disabled to perform the services

of that employment, unless that disability is removed before the close of that period and the taxpayer fails to offer reemployment to that individual.

(iii) A termination of employment of an individual, if it is determined that the termination was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that individual.

(iv) A termination of employment of an individual due to a substantial reduction in the trade or business operations of the taxpayer.

(v) A termination of employment of an individual, if that individual is replaced by other qualified employees so as to create a net increase in both the number of employees and the hours of employment.

(B) Subparagraph (B) of paragraph (1) shall not apply to any of the following:

(i) A failure to continue the seasonal employment of a qualified disadvantaged individual who voluntarily fails to return to the seasonal employment of the qualified taxpayer.

(ii) A failure to continue the seasonal employment of a qualified disadvantaged individual who, before the close of the period referred to in subparagraph (B) of paragraph (1), becomes disabled and unable to perform the services of that seasonal employment, unless that disability is removed before the close of that period and the qualified taxpayer fails to offer seasonal employment to that qualified disadvantaged individual.

(iii) A failure to continue the seasonal employment of a qualified disadvantaged individual, if it is determined that the failure to continue the seasonal employment was due to the misconduct (as defined in Sections 1256-30 to 1256-43, inclusive, of Title 22 of the California Code of Regulations) of that individual.

(iv) A failure to continue seasonal employment of a qualified disadvantaged individual due to a substantial reduction in the regular seasonal trade or business operations of the qualified taxpayer.

(v) A failure to continue the seasonal employment of a qualified disadvantaged individual, if that individual is replaced by other qualified disadvantaged individuals so as to create a net increase in both the number of seasonal employees and the hours of seasonal employment.

(C) For purposes of paragraph (1), the employment relationship between the taxpayer and an employee shall not be treated as terminated by either of the following:

(i) A transaction to which Section 381(a) of the Internal Revenue Code applies, if the employee continues to be employed by the acquiring corporation.

(ii) A mere change in the form of conducting the trade or business of the taxpayer, if the employee continues to be employed in that trade or business and the taxpayer retains a substantial interest in that trade or business.

(3) Any increase in tax under paragraph (1) shall not be treated as tax imposed by this part for purposes of determining the amount of any credit allowable under this part.

(4) At the close of the second ~~income~~ *taxable* year, if the taxpayer has not increased the number of its employees as determined by paragraph (5) of subdivision (b), then the amount of the credit previously claimed shall be added to the taxpayer's tax for the taxpayer's second ~~income~~ *taxable* year.

(e) In the case of an organization to which Section 593 of the Internal Revenue Code applies, and a regulated investment company or a real estate investment trust subject to taxation under this part, rules similar to the rules provided in Section 46(e) and Section 46(h) of the Internal Revenue Code shall apply.

(f) The credit shall be reduced by the credit allowed under Section 23621. The credit shall also be reduced by the federal credit allowed under Section 51 of the Internal Revenue Code.

In addition, any deduction otherwise allowed under this part for the wages or salaries paid or incurred by the taxpayer upon which the credit is based shall be reduced by the amount of the credit, prior to any reduction required by subdivision (g) or (h).

(g) In the case where the credit otherwise allowed under this section exceeds the ‘‘tax’’ for the ~~income~~ *taxable* year, that portion of the credit that exceeds the ‘‘tax’’ may be carried over and added to the credit, if any, in succeeding years, until the credit is exhausted. The credit shall be applied first to the earliest ~~income~~ *taxable* years possible.

(h) (1) The amount of credit otherwise allowed under this section and Section 23645, including any prior year carryovers, that may reduce the ‘‘tax’’ for the ~~income~~ *taxable* year shall not exceed the amount of tax that would be imposed on the taxpayer’s business income attributed to a LAMBRA determined as if that attributed income represented all of the income of the taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer’s California source business income that is apportioned to the LAMBRA. For that purpose, the taxpayer’s business income that is attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the LAMBRA in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Income shall be apportioned to a LAMBRA by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer’s real and tangible personal property owned or rented and used in the LAMBRA during the ~~income~~ *taxable* year, and the denominator of which is the average value of all the taxpayer’s real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the LAMBRA during the ~~income~~ *taxable* year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ *taxable* year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding ~~income~~ *taxable* years, as if it were an amount exceeding the ''tax'' for the ~~income~~ *taxable* year, as provided in subdivision (g).

(i) If the taxpayer is allowed a credit pursuant to this section for qualified wages paid or incurred, only one credit shall be allowed to the taxpayer under this part with respect to any wage consisting in whole or in part of those qualified wages.

SEC. 88. Section 23649 of the Revenue and Taxation Code is amended to read:

23649. (a) (1) A qualified taxpayer shall be allowed a credit against the ''tax,'' as defined in Section 23036, equal to 6 percent of the qualified cost of qualified property that is placed in service in this state.

(2) In the case of any qualified costs paid or incurred on or after January 1, 1994, and prior to the first ~~income~~ *taxable* year of the qualified taxpayer beginning on or after January 1, 1995, the credit provided under paragraph (1) shall be claimed by the qualified taxpayer on the qualified taxpayer's return for the first ~~income~~ *taxable* year beginning on or after January 1, 1995. No credit shall be claimed under this section on a return filed for any ~~income~~ *taxable* year commencing prior to the qualified taxpayer's first ~~income~~ *taxable* year beginning on or after January 1, 1995.

(b) (1) For purposes of this section, ''qualified cost'' means any cost that satisfies 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,

1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i). 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 prior to January 1, 1994, 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, 1994, and total contract costs actually paid. ''Cost paid'' shall include, without limitation, contractual deposits and option payments. To the extent of cost allocated, whether or not currently deductible or depreciable for tax purposes, to a period prior to January 1, 1994, the cost shall be deemed allocated to property acquired before January 1, 1994, and is thus not a ''qualified cost.''

(B) Except as provided in paragraph (3) of subdivision (d) and subparagraph (B) of paragraph (4) 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, 1994, that is a successor or replacement contract to a contract that was binding prior to January 1, 1994, shall be treated as a binding contract in existence prior to January 1, 1994.

(B) If a successor or replacement contract is entered into on or after January 1, 1994, 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, 1994, under subparagraph (A) of paragraph (1).

(3) (A) For purposes of this section, an option contract in existence prior to January 1, 1994, 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.

(4) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, ''the first ~~income~~ *taxable* year beginning on or after January 1, 1998,'' shall be substituted for ''January 1, 1994,'' in each place in which it appears.

(c) (1) For purposes of this section, ''qualified taxpayer'' means any taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer shall be made at the entity level and any credit under this section or Section 17053.49 shall be allowed to the passthrough 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 ‘‘passthrough 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) For purposes of this section, ‘‘qualified property’’ means property that is described as either of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, or recycling 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, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(B) In research and development.

(C) To maintain, repair, measure, or test any property described in this paragraph.

(D) For pollution control that meets or exceeds standards established by the state or by any local or regional governmental agency within the state.

(E) For recycling.

(2) Computers and computer peripheral equipment, as defined in Section 168(i)(2)(B) of the Internal Revenue Code, that is tangible personal property as defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business

described in SIC Codes 7371 to 7373, inclusive, of the SIC Manual, 1987 edition, that is primarily used to develop or manufacture prepackaged software or custom software prepared to the special order of the purchaser who uses the program to produce and sell or license copies of the program as prepackaged software.

(3) The value of any capitalized labor costs that are directly allocable to the construction or modification of property described in paragraph (1) or (2).

(4) In the case of any qualified taxpayer engaged in manufacturing activities described in SIC Code 357 or 367, those activities related to biotechnology described in SIC Code 8731, those activities related to biopharmaceutical establishments only that are described in SIC Codes 2833 to 2836, inclusive, those activities related to space vehicles and parts described in SIC Codes 3761 to 3769, inclusive, those activities related to space satellites and communications satellites and equipment described in SIC Codes 3663 and 3812 (but only with respect to ‘‘qualified property’’ that is placed in service on or after January 1, 1996), or those activities related to semiconductor equipment manufacturing described in SIC Code 3559 (but only with respect to ‘‘qualified property’’ that is placed in service on or after January 1, 1997), ‘‘qualified property’’ also includes the following:

(A) Special purpose buildings and foundations that are constructed or modified for use by the qualified taxpayer primarily in a manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(B) The value of any capitalized labor costs that are directly allocable to the construction or modification of special purpose buildings and foundations that are used primarily in the manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(C) (i) For purposes of this paragraph, ‘‘special purpose building and foundation’’ means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subparagraph (A) (‘‘qualified purpose’’).

(ii) A building is specifically designed and constructed or modified for a qualified purpose if it is not economical to design and construct the building for the intended purpose and then use the structure for a different purpose.

(iii) For purposes of clause (i) and clause (vi), a building is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building for nonqualified purposes does not preclude the building from being a special purpose building. ‘‘Incidental use’’ means a use which is both related and subordinate to the qualified purpose. It will be conclusively presumed that a use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualified purpose.

(iv) In the event an entire building does not qualify as a special purpose building, a taxpayer may establish that a portion of a building, and the foundation immediately underlying the portion, qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subparagraph.

(v) To the extent that a building is not a special purpose building as defined above, but a portion of the building qualifies for treatment as a special purpose building, then all equipment which exclusively supports the qualified purpose occurring within that portion and

which would qualify as Internal Revenue Code Section 1245 property if it were not a fixture or affixed to the building shall be treated as a cost of the portion of the building which qualifies for treatment as a special purpose building.

(vi) Buildings and foundations which do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to: buildings designed and constructed or reconstructed principally to function as a general purpose manufacturing, industrial, or commercial building; research facilities that are used primarily prior to or after, or prior to and after, the manufacturing process; or storage facilities that are used primarily prior to or after, or prior to and after, completion of the manufacturing process. A research facility shall not be considered to be used primarily prior to or after, or prior to and after, the manufacturing process if its purpose and use relate exclusively to the development and regulatory approval of the manufacturing process for specific biopharmaceutical products. A research facility which is used primarily in connection with the discovery of an organism from which a biopharmaceutical product or process is developed does not meet the requirements of the preceding sentence.

(5) Subject to the provisions in subparagraph (B) of paragraph (1) of subdivision (b), qualified property also includes computer software that is primarily used for those purposes set forth in paragraph (1) or (2) of this subdivision.

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

(A) Furniture.

(B) Facilities used for warehousing purposes after completion of the manufacturing process.

(C) Inventory.

(D) Equipment used in the extraction process.

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

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

(G) Any vehicle for which a credit is claimed pursuant to Section 17052.11 or 23603.

(e) For purposes of this section:

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

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

(3) ‘‘Manufacturing’’ means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(4) ‘‘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.

(5) ‘‘Primarily’’ means tangible personal property used 50 percent or more of the time in an activity described in 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, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling 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, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer's manufacturing, processing, refining, fabricating, or recycling activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

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

(8) ''Refining'' means the process of converting a natural resource to an intermediate or finished product.

(9) ''Research and development'' means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) ''Small business'' means a qualified taxpayer that meets any of the following requirements during the ~~income~~ *taxable* year for which the credit is allowed:

(A) Has gross receipts of less than fifty million dollars ($50,000,000).

(B) Has net assets of less than fifty million dollars ($50,000,000).

(C) Has a total credit of less than one million dollars ($1,000,000).

(D) For ~~income~~ *taxable* years beginning on or after January 1, 1997, 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 has not received regulatory approval for any product from the United States Food and Drug Administration.

(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’’ shall include 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 24912) of the qualified property that is the subject of the lease.

(iii) Except as provided in clause (iv), 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 and clause (iv), 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 or under clause (iv).

(iv) With respect to leases entered into between January 1, 1994, and the effective date of this clause, the lessor may elect to pay use tax measured by the purchase

price of the property by reporting and paying the tax with the return of the lessor for the fourth calendar quarter of 1994. In computing the use tax under the preceding sentence, a credit shall be allowed under Part 1 (commencing with Section 6001) for all sales or use tax previously paid on the lease.

(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 any 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 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, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i), 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, 1994, 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.

(6) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the

United States Office of Management and Budget, 1987 edition, ''the first ~~income~~ *taxable* year beginning on or after January 1, 1998,'' shall be substituted for ''January 1, 1994,'' in each place in which it appears. In addition, ''the effective date of this paragraph'' shall be substituted for ''the effective date of this clause'' and ''fourth calendar quarter of 1998'' shall be substituted for ''fourth calendar quarter of 1994.''

(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 qualified property is first placed 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 qualified property is first placed 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 ''tax,'' the excess may be carried over to reduce the ''tax'' in the following year, and succeeding years as follows:

(1) Except as provided in paragraph (2), for the seven succeeding years if necessary, until the credit is exhausted.

(2) In the case of a small business, for the nine succeeding years, if necessary, until the credit is exhausted.

(i) (1) This section shall remain in effect until the date specified in paragraph (2) on which date this section shall cease to be operative, and as of that date is repealed.

(2) (A) This section shall cease to be operative on January 1, 2001, or on January 1 of the earliest year thereafter, if the total employment in this state, as

determined by the Employment Development Department on the preceding January 1, does not exceed by 100,000 jobs the total employment in this state on January 1, 1994. The department shall report to the Legislature annually with respect to the determination required by the preceding sentence.

(B) For purposes of this paragraph, ‘‘total employment’’ means the total employment in the manufacturing sector, excluding employment in the aerospace sector.

(j) The amendments made by the act adding this subdivision shall be operative for ~~income~~ *taxable* years beginning on or after January 1, 1997, except as provided in paragraph (3) of subdivision (d).

(k) The amendments made by the act adding this subdivision shall be operative for ~~income~~ *taxable* years beginning on or after January 1, 1998.

SEC. 89. Section 23657 of the Revenue and Taxation Code is amended to read:

23657. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1997, and before January 1, 2002, there shall be allowed as a credit against the amount of ‘‘tax,’’ as defined in Section 23036, an amount equal to 20 percent of the amount of each qualified deposit made by a taxpayer during the ~~income~~ *taxable* year into a community development financial institution.

(b) Notwithstanding any other provision of this part, no credit shall be allowed under this section unless the California Organized Investment Network of the Department of Insurance, or its successor, certifies that the deposit described in subdivision (a) qualifies for the credit under this section and certifies the total amount of the credit allocated to the taxpayer pursuant to this section. The aggregate amount of qualified deposits made by all taxpayers pursuant to this section and Section 17053.57 shall not exceed ten million dollars ($10,000,000) for each calendar year.

(c) The Community Development Financial Institution shall do all of the following:

(1) Apply to the California Organized Investment Network, or its successor, for certification of its status as a Community Development Financial Institution.

(2) Apply to the California Organized Investment Network, or its successor, on behalf of the taxpayer, for certification of the credit amount allocated to the taxpayer prior to accepting any qualified deposit from the taxpayer.

(3) Transmit to the taxpayer and the California Organized Investment Network, or its successor, certification that a qualified deposit has been accepted, amount of the deposit or equity investment, and the amount of credit to which the taxpayer is entitled, and retain a copy of the certification.

(4) Obtain the taxpayer's identification number, or in the case of an ''S corporation,'' the taxpayer identification numbers of all the shareholders for tax administration purposes and provide this information to the California Organized Investment Network, or its successor, with the transmittal required in paragraph (3).

(5) Provide an annual listing to the Franchise Tax Board, in the form and manner agreed upon by the Franchise Tax Board and the California Organized Investment Network, or its successor, of the names and taxpayer identification numbers of any taxpayer who makes any withdrawal or partial withdrawal of a qualified deposit before the expiration of 60 months from the date of the qualified deposit.

(d) The California Organized Investment Network, or any successor thereof, shall do all of the following:

(1) Accept applications for certification from financial institutions and issue certificates that the applicant is a Community Development Financial Institution qualified to receive qualified deposits.

(2) Accept applications for certification from any Community Development Financial Institution on behalf of the taxpayer and issue certificates to taxpayers in an aggregate amount that shall not exceed the limit specified in subdivision (b). The certificate shall include the amount eligible to be made as a deposit or equity

investment that qualifies for the credit and the total amount of the credit to which the taxpayer is entitled for the ~~income~~ *taxable* year. Certificates shall be issued in the order that the applications are received.

(3) Provide an annual listing to the Franchise Tax Board, in the form or manner agreed upon by the Franchise Tax Board and the California Organized Investment Network, or its successor, of the taxpayers who were issued certificates, their respective tax identification numbers, the amount of the qualified deposit made by each taxpayer, and the total amount of all qualified deposits.

(e) For purposes of this section:

(1) ''Qualified deposit'' means a deposit that does not earn interest, or an equity investment, that is equal to or greater than fifty thousand dollars ($50,000) and is made for a minimum duration of 60 months.

(2) ''Community development financial institution'' means a private financial institution located in this state that is certified by the California Organized Investment Network, or its successor, that has community development as its primary mission, and that lends in urban, rural, or reservation-based communities in this state. A community development financial institution may include a community development bank, a community development loan fund, a community development credit union, a microenterprise fund, a community development corporation-based lender, and a community development venture fund.

(f) (1) If a qualified deposit is withdrawn before the end of the 60th month and not redeposited or reinvested in another Community Development Financial Institution within 60 days, there shall be added to the ''tax,'' as defined in Section 23036, for the ~~income~~ *taxable* year in which the withdrawal occurs, the entire amount of any credit previously allowed under this section.

(2) If a qualified deposit is reduced before the end of the 60th month, but not below fifty thousand dollars ($50,000), there shall be added to the ''tax,'' as defined in Section 23036, for the ~~income~~ *taxable* year in which the

reduction occurs, an amount equal to 20 percent of the total reduction for the ~~income~~ *taxable* year.

(g) In the case where the credit allowed by this section exceeds the ''tax,'' the excess may be carried over to reduce the ''tax'' for the next four ~~income~~ *taxable* years, or until the credit has been exhausted, whichever occurs first.

(h) This section shall remain in effect only until December 1, 2002, and as of that date is repealed.

SEC. 90. Section 23666 of the Revenue and Taxation Code is amended to read:

23666. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1995, and before January 1, 2000, there shall be allowed, as determined by the Department of Fish and Game, a credit against the ''tax,'' as defined in Section 23036. The credit amount shall be equal to the lesser of 10 percent of the qualified costs paid or incurred by the taxpayer for salmon and steelhead trout habitat restoration and improvement projects or an amount determined in subparagraph (B) of paragraph (2) of subdivision (f). The credit allowed by this section shall be claimed on the return for the ~~income~~ *taxable* year in which the expense for the habitat restoration or improvement project was paid or incurred.

(b) A taxpayer shall be eligible to claim the credit only after application to and certification by the Department of Fish and Game that all of the following conditions are met:

(1) The salmon or steelhead trout habitat restoration or improvement project meets the objectives of the Salmon, Steelhead Trout, and Anadromous Fisheries Program Act (Chapter 8 (commencing with Section 6900) of Part 1 of Division 6 of the Fish and Game Code) and would aid in increasing the natural production of salmon and steelhead trout through improvement of stream and streambank conditions, improvement of land use practices, or changes in streamflow operations.

(2) The work to be undertaken is not otherwise required to be carried out pursuant to the Z'berg-Nejedly Forest Practice Act of 1973 (Chapter 8 (commencing

with Section 4511) of Part 2 of Division 4 of the Public Resources Code), for mitigation of negative impacts to the environment caused by timber operations or required for mitigation of negative impacts on fish and wildlife habitat caused by a project pursuant to an approved environmental impact report or mitigated negative declaration required pursuant to the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code).

(c) (1) Qualified costs are those costs paid or incurred by the taxpayer which are directly related to labor and materials which aid in increasing the natural production of salmon and steelhead trout through improvement of stream and streambank conditions, improvement of land use practices, or changes in streamflow operations.

(2) Qualified costs do not include costs paid or incurred with respect to any of the following:

(A) Construction of office, storage, garage, or maintenance buildings.

(B) Drilling wells or installation of pumping equipment.

(C) Construction of permanent hatchery facilities, including raceways, water systems, or bird enclosures.

(D) Construction of permanent surface roadways or bridges.

(E) Any project requiring engineered design or certification by a registered engineer.

(3) Qualified costs shall be no greater than prevailing costs for similar work completed in the area where the project is proposed, and the project design and implementation shall follow the Department of Fish and Game guidelines.

(d) For purposes of computing the credit provided by this section, the cost of any salmon or steelhead trout habitat restoration or improvement project eligible for the credit shall be reduced by the amount of any grant or cost-share payment provided by a public entity for that project. The Department of Fish and Game shall certify the amount of funding, if any, provided by the Department of Fish and Game for the project.

(e) The taxpayer shall do all of the following:

(1) (A) Submit an application for the restoration tax credit with a description of the proposed project in a format acceptable to the Department of Fish and Game.

(B) The application for the restoration tax credit shall include all information that is required by the Department of Fish and Game, pursuant to subdivision (b), as well as, but not limited to, all of the following:

(i) A project description of the habitat restoration or improvement work to be accomplished, including the location of the project.

(ii) If other than the project applicant, the name of the owner of the land where the project is to be carried out.

(iii) The estimated qualified cost to accomplish the project, as well as the project's overall estimated cost.

(iv) A statement that a reasonable attempt will be made to hire unemployed persons previously employed in the commercial fishing or forest products industries for implementation of the project.

The tax identification number of each taxpayer allowed the credit.

(2) Obtain from the Department of Fish and Game certification that the project is approved, and the amount of credit allocation authorized, which shall not exceed the maximum amount of credit allocation set forth in subdivision (k).

(3) Notify the Department of Fish and Game in a form and manner specified by the department that the habitat restoration or improvement work was actually completed and the amount of qualified costs that were paid.

(4) Provide access, subject to prior notification by the Department of Fish and Game staff and permission by the taxpayer, to proposed project sites by the Department of Fish and Game staff for preproject and postproject evaluation, for project monitoring during all phases of implementation, and for verification that projects have been completed in accordance with department guidelines and recommendations. The Department of Fish and Game shall not include a project on its list of approved projects eligible for the tax credit

that is submitted to the Franchise Tax Board unless these conditions are met.

(5) Retain a copy of and make the certification referred to in paragraph (3) of subdivision (f) available to the Franchise Tax Board upon demand.

(6) Calculate the credit amount, equal to the lesser of 10 percent of the taxpayer's actual qualified costs or the amount of credit allocation authorized to the taxpayer, as determined by the Department of Fish and Game.

(f) The Department of Fish and Game shall do all of the following:

(1) Accept and review applications to determine if projects meet the conditions specified in subdivision (b).

(2) After all applications have been received for a calendar year, determine if 10 percent of the estimated costs for all approved projects exceeds the annual credit allocation. If the annual amount of credit allocation is exceeded, the amount of each taxpayer's credit allocation shall be calculated as follows:

(A) Divide the annual amount of credit allocation set forth in subdivision (j) by the total estimated qualified costs for all approved projects.

(B) Multiply each approved project's estimated qualified cost by the quotient of the calculation in subparagraph (A).

(C) If the annual amount of credit allocation is not exceeded, the amount of each credit allocation shall be 10 percent of the estimated qualified costs.

(3) Issue certificates to each taxpayer with an approved project that specifies the amount of credit allocated to the project.

(4) Provide an annual listing to the Franchise Tax Board (preferably on magnetic tape or other machine-readable form, and in a form and manner agreed upon by the Franchise Tax Board and the Department of Fish and Game) of the taxpayers who were issued the certification, their respective tax identification numbers, and the allowable amount of the credit allocated to each taxpayer.

(g) The Department of Fish and Game shall have the authority to establish annual timeframes for the receipt of applications.

(h) The taxpayers' identification numbers obtained through the tax credit application and certification process shall be used exclusively for state tax administrative purposes.

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

(j) For purposes of this section, the annual amount of credit allocation means the aggregate amount of tax credits which may be granted pursuant to this section and Section 17053.66 shall not exceed five hundred thousand dollars ($500,000) per year. The Department of Fish and Game shall not authorize any credit which would cause the total amount of credits authorized with respect to any calendar year under this section and Section 17053.66 to exceed five hundred thousand dollars ($500,000).

(k) The maximum credit amount which the Department of Fish and Game may authorize with respect to any ~~income~~ *taxable* year to any taxpayer is fifty thousand dollars ($50,000).

(*l*) In the case of a partnership, the credit limitation specified in subdivision (k) shall apply with respect to the partnership and with respect to each partner.

(m) This section shall remain in effect only until December 1, 2000, and as of that date is repealed.

SEC. 91. Section 23701a of the Revenue and Taxation Code is amended to read:

23701a. (a) Labor, agricultural, or horticultural organizations other than cooperative organizations described in Section 24404 or 24405 (unless the cooperative organization is determined by the Internal Revenue Service to be an organization described in Section 501(c)(5) of the Internal Revenue Code of 1954, as amended).

For purposes of this section, the term ‘‘agricultural’’ includes the art or science of cultivating land, harvesting crops or aquatic resources, or raising livestock.

(b) The amendments to this section by the act adding this subdivision shall be applied in the computation of taxes for ~~income~~ *taxable* years beginning on or after January 1, 1983.

SEC. 92. Section 23701n of the Revenue and Taxation Code is amended to read:

23701n. (a) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if—

(1) Under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the ~~income~~ *taxable* year or thereafter) used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits,

(2) Such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Franchise Tax Board not to be discriminatory in favor of employees who are highly compensated employees within the meaning of Section 414(q) of the Internal Revenue Code, and

(3) Such benefits do not discriminate in favor of employees who are highly compensated employees within the meaning of Section 414(q) of the Internal Revenue Code. A plan shall not be considered discriminatory within the meaning of this clause merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(b) In determining whether a plan meets the requirements of subdivision (a), any benefits provided under any other plan shall not be taken into consideration, except that a plan shall not be considered discriminatory—

(1) Merely because the benefits under the plan which are first determined in a nondiscriminatory manner within the meaning of subdivision (a) are then reduced by any sick, accident, or unemployment compensation benefits received under state or federal law (or reduced by a portion of such benefits if determined in a nondiscriminatory manner), or

(2) Merely because the plan provides only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under state or federal law the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such laws if such employees were eligible for such benefits, or

(3) Merely because the plan provides only for employees who are not eligible under another plan (which meets the requirements of subdivision (a)) of supplemental unemployment compensation benefits provided wholly by the employer the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such other plan if such employees were eligible under such other plan, but only if the employees were eligible under both plans would make a classification which would be nondiscriminatory within the meaning of subdivision (a).

(c) A plan shall be considered to meet the requirements of subdivision (a) during the whole of any year of the plan if on one day in each quarter it satisfies such requirements.

(d) The term ‘‘supplemental unemployment compensation benefits’’ means only—

(1) Benefits which are paid to an employee because of his or her involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and

(2) Sick and accident benefits subordinate to the benefits described in paragraph (1).

(e) Exemption shall not be denied under this article to any organization entitled to such exemption as an association described in Section 23701i merely because such organization provides for the payment of supplemental unemployment benefits (as defined in paragraph (1) of subdivision (d)).

SEC. 93. Section 23701s of the Revenue and Taxation Code is amended to read:

23701s. A trust or trusts created before June 25, 1959, forming part of a plan providing for the payment of benefits under a pension plan funded only by contributions of employees, if—

(a) Under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of benefits under the plan,

(b) Those benefits are payable to employees under a classification ~~which~~ *that* is set forth in the plan and which is found by the Franchise Tax Board not to be discriminatory in favor of employees who are highly compensated employees within the meaning of Section 414(q) of the Internal Revenue Code, and

(c) Those benefits do not discriminate in favor of employees who are highly compensated employees within the meaning of Section 414(q) of the Internal Revenue Code. A plan shall not be considered discriminatory within the meaning of this paragraph merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan, and

(d) In the case of a plan under which an employee may designate certain contributions as deductible—

(1) Those contributions do not exceed the amount with respect to which a deduction is allowable under Section 219(b)(3) of the Internal Revenue Code,

(2) Requirements similar to the requirements of Section 401(k)(3)(A)(ii) of the Internal Revenue Code are met with respect to those elective contributions.

(3) Those contributions are treated as elective deferrals for purposes of Section 402(g) (other than paragraph (4) thereof) of the Internal Revenue Code, and

(4) The requirements of Section 401(a)(30) of the Internal Revenue Code are met.

SEC. 94. Section 23703 of the Revenue and Taxation Code is amended to read:

23703. (a) No exemption shall be allowed under this article to any charitable corporation as defined in Sections 12582.1 and 12583 of the Government Code for any year or years for which it fails to file with the Attorney General, on or before the due date, any registration or periodic report required by Article 7 (commencing with Section 12580) of Chapter 6, Part 2, Division 3, Title 2, of the Government Code.

(b) The exemption shall be disallowed under this section only after the Attorney General has notified the Franchise Tax Board in writing that a charitable corporation subject to the provisions of subdivision (a) has failed to file any such registration or periodic report on or before the due date thereof.

(c) If an exemption is disallowed under this section, such exemption may be reinstated when the registration or periodic reports are filed; however, any such charitable corporation shall pay the minimum tax provided for by Section 23153 for any year or years for which its exemption was disallowed under this section.

(d) No exemption shall be disallowed under this section for ~~income~~ *taxable* years commencing before January 1, 1962.

(e) The Franchise Tax Board may make any regulations which it deems necessary to effectuate the purposes of this section.

SEC. 95. 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 that 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 those 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 that is exempt from taxation under Section 23701, or

(B) A constituent part of an organization described in Section 23701d that is exempt from taxation under Section 23701 and that, 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~~ *taxable* year, all net earnings to members on the basis of services performed for them.

(c) If the organization has capital stock, all of that stock outstanding is owned by its members.

For purposes of this part, any organization that, 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. 96. Section 23731 of the Revenue and Taxation Code is amended to read:

23731. Every organization or trust exempt under this chapter, except as provided in this article, is subject to the tax imposed upon its unrelated business taxable income, as defined in Section 23732, as follows:

(a) Corporations (other than banks and financial corporations), associations, and business trusts are subject to the tax imposed under Section 23501.

(b) Trusts are subject to the tax imposed by subdivision (e) of Section 17041.

This section applies to ~~income~~ *taxable* years beginning after December 31, 1970.

SEC. 97. Section 23735 of the Revenue and Taxation Code is amended to read:

23735. (a) Section 514 of the Internal Revenue Code, relating to unrelated debt-financed income, shall apply, except as otherwise provided.

(b) Section 10214 of Public Law 100-203, relating to the treatment of certain partnership allocations, shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1990, for property acquired by the partnership after October 13, 1987, and partnership interests acquired after October 13, 1987.

(c) An interest in a participation agreement, as defined in subdivision (i) of Section 69980 of the Education Code, shall not be treated as debt.

SEC. 98. Section 23736.3 of the Revenue and Taxation Code is amended to read:

23736.3. An organization described in Section 23701n or Section 23701d, except as specified in Section 23736, shall be denied exemption under Section 23736.2 only for ~~income~~ *taxable* years subsequent to the ~~income~~ *taxable* years during which it is notified by the Franchise Tax Board that it has engaged in a prohibited transaction, unless such organization entered into such prohibited transaction with the purpose of diverting corpus or

income of the organization from its exempt purposes, and such transaction involved a substantial part of the corpus or income of such organization.

SEC. 99. Section 23736.4 of the Revenue and Taxation Code is amended to read:

23736.4. Any organization denied exemption under Section 23701d or Section 23701n by reason of the provisions of Section 23736.2 with respect to any ~~income~~ *taxable* year following the ~~income~~ *taxable* year in which notice of denial of exemption was received, may, under regulations prescribed by the Franchise Tax Board, file claim for exemption, and if the Franchise Tax Board pursuant to such regulations, is satisfied that such organizations will not knowingly again engage in a prohibited transaction, such organization shall be exempt with respect to ~~income~~ *taxable* years subsequent to the year in which such claim is filed.

SEC. 100. Section 23737 of the Revenue and Taxation Code is amended to read:

23737. In the case of any organization described in Section 23701d to which this article is applicable, exemption under Article 1 (commencing with Section 23701) shall be denied for the ~~income~~ *taxable* year if the amounts accumulated out of income during the ~~income~~ *taxable* year or any prior ~~income~~ *taxable* year and not actually paid out by the end of the ~~income~~ *taxable* year—

(a) Are unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 23701d; or

(b) Are used to a substantial degree for purposes or functions other than those constituting the basis for such organization's exemption under Section 23701d, or

(c) Are invested in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for such organization's exemption under Section 23701d.

SEC. 101. 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~~ *taxable* 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~~ *taxable* year.

SEC. 102. Section 23772 of the Revenue and Taxation Code is amended to read:

23772. (a) For the purposes of this part—

(1) Except as provided in paragraph (2) every organization exempt from taxation under Section 23701 and every trust treated as a private foundation because of Section 4947(a)(1) of the Internal Revenue Code shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the laws under this part as the Franchise Tax Board may by rules or regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Franchise Tax Board may from time to time prescribe. The return shall be filed on or before the 15th day of the fifth full calendar month following the close of the ~~income~~ *taxable* year.

(2) Exceptions from filing—

(A) Mandatory exceptions—Paragraph (1) shall not apply to—

(i) Churches, their integrated auxiliaries, and conventions or association of churches,

(ii) Any organization (other than a private foundation as defined in Section 23709), the gross receipts of which

in each taxable year are normally not more than twenty-five thousand dollars ($25,000), or

(iii) The exclusively religious activities of any religious order,

(B) Discretionary exceptions—The Franchise Tax Board may permit the filing of a simplified return for organizations based on either gross receipts or total assets or both gross receipts and total assets, or may permit the filing of an information statement (without fee), or may permit the filing of a group return for incorporated or unincorporated branches of a state or national organization where it determines that an information return is not necessary to the efficient administration of this part.

(3) An organization that is required to file an annual information return shall pay a filing fee of ten dollars ($10) on or before the due date for filing the annual information return (determined with regard to any extension of time for filing the return) required by this section. In case of failure to pay the fee on or before such due date unless it is shown that such failure is due to reasonable cause, the filing fee shall be twenty-five dollars ($25). All collection remedies provided in Article 5 (commencing with Section 18661) of Chapter 2 of Part 10.2 shall be applicable to collection of the filing fee. However, the filing fee shall not apply to the organization described in paragraph (4).

(4) Paragraph (3) shall not apply to: (A) a religious organization exempt under Section 23701d; (B) an educational organization exempt under Section 23701d, if such organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (C) a charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under Section 23701d, if such organization is supported, in whole or in part, by funds contributed by the United States or any state or political subdivision thereof, or is primarily supported by contributions of the general

public; (D) an organization exempt under Section 23701d, if such organization is operated, supervised, or controlled by or in connection with a religious organization described in subparagraph (A).

(b) Every organization described in Section 23701d which is subject to the requirements of subdivision (a) shall furnish annually information, at such time and in such manner as the Franchise Tax Board may by rules or regulations prescribe, setting forth—

(1) Its gross income for the year,

(2) Its expenses attributable to such income and incurred within the year,

(3) Its disbursements within the year for the purposes for which it is exempt,

(4) A balance sheet showing its assets, liabilities, and net worth as of the beginning of such year,

(5) The total of the contributions and gifts received by it during the year, and the names and addresses of all substantial contributors,

(6) The names and addresses of its foundation manager (within the meaning of Section 4946 of the Internal Revenue Code) and highly compensated employees,

(7) The compensation and other payments made during the year to each individual described in paragraph (6),

(8) In the case of an organization with respect to which an election under Section 23704.5 is effective for the taxable year, the following amounts for such organization for such taxable year:

(A) The lobbying expenditures (as defined in Section 23740(c)(1)).

(B) The lobbying nontaxable amount (as defined in Section 23740(c)(2)).

(C) The grassroots expenditures (as defined in Section 23740(c)(3)).

(D) The grassroots nontaxable amount (as defined in Section 23740(c)(4)). For purposes of this paragraph, if Section 23740(f) applies to the organization for the taxable year, the organization shall furnish the amounts

with respect to the affiliated group as well as with respect to the organization.

(9) Such other information with respect to direct or indirect transfers to, and other direct or indirect transactions and relationships with, other organizations described in Sections 23701a to 23701w, inclusive (other than Sections 23701d, 23701k, and 23701t), as the Franchise Tax Board may require to prevent either of the following:

(A) Diversion of funds from the organization's exempt purpose.

(B) Misallocation of revenue or expense, and

(10) Any other relevant information as the Franchise Tax Board may prescribe.

(c) In addition to the above annual return any organization which is required to file an annual report under Section 6056 of the Internal Revenue Code will furnish a copy of the report to the Franchise Tax Board at the time the annual return is due.

(d) For the purposes of this part—

(1) In the case of a failure to file a return required under this section on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Franchise Tax Board and in the same manner as tax) by the exempt organization or trust failing so to file, five dollars ($5) for each month or part thereof during which such failure continues, but the total amount imposed hereunder on any organization for failure to file any return shall not exceed forty dollars ($40).

(2) The Franchise Tax Board may make written demand upon a private foundation failing to file under paragraph (1) of this subdivision or subdivision (c) specifying therein a reasonable future date by which such filing shall be made, and if such filing is not made on or before such date, and unless it is shown that failure so to file is due to reasonable cause, there shall be paid (on notice and demand by the Franchise Tax Board and in the

same manner as tax) by the person failing so to file, in addition to the penalty prescribed in paragraph (1), a penalty of five dollars ($5) each month or part thereof after the expiration of the time specified in the written demand during which such failure continues, but the total amount imposed hereunder on all persons for such failure to file shall not exceed twenty-five dollars ($25). If more than one person is liable under this paragraph for a failure to file, all such persons shall be jointly and severally liable with respect to such failure. The term ‘‘person’’ as used herein means any officer, director, trustee, employee, member, or other individual who is under a duty to perform the act in respect of which the violation occurs.

(e) The reporting requirements and penalties shall be applicable for ~~income~~ *taxable* years beginning after December 31, 1970, except that the provisions of subparagraph (B) of paragraph (2) of subdivision (a) shall apply to ~~income~~ *taxable* years ending after December 31, 1970.

SEC. 103. Section 23774 of the Revenue and Taxation Code is amended to read:

23774. (a) Except as provided in subdivision (b), every organization exempt from filing an annual information return by reason of subdivision (a) of Section 23772, may be required to file an annual statement on or before the 15th day of the fifth calendar month following the close of the ~~income~~ *taxable* year setting forth in the manner as may be required by the Franchise Tax Board the following information: the name and address of the organization, its major activities, its sources of income, and the section of the Internal Revenue Code under which it is exempt. Organizations other than those described in clause (i) and (iii) of subparagraph (A) of paragraph (2) of subdivision (a) of Section 23772 may also be required by the Franchise Tax Board to furnish information with respect to their gross receipts and their assets.

(b) Every religious organization exempt from filing an annual information return by reason of subdivision (a) of

Section 23772, which because of sincerely held religious convictions refuses to file an annual statement as prescribed in subdivision (a), may submit in lieu thereof a notarized statement on its organizational letterhead containing the following information: the name and address of the organization, its major activities, its sources of income, and the section of the Internal Revenue Code under which it is exempt. That information shall be for the sole purpose of verifying the absence of unrelated business income of the organization. The statement shall be submitted on or before the 15th day of the fifth calendar month following the close of the ~~income~~ *taxable* year.

SEC. 104. Section 23775 of the Revenue and Taxation Code is amended to read:

23775. Except for purposes of amending the articles of incorporation to set forth a new name, under regulations prescribed by the Franchise Tax Board, the corporate powers, rights and privileges of an exempt domestic corporation may be suspended and the exercise of the corporate powers, rights and privileges of a foreign exempt corporation in this state may be forfeited if the organization fails to file the annual return or statement required under Section 23772 or 23774, or pay any amount due under Section 23703 or 23772 on or before the last day of the 12th month following the close of the ~~income~~ *taxable* year.

SEC. 105. Section 23777 of the Revenue and Taxation Code is amended to read:

23777. The exemption granted to any organization under the provisions of Article 1 (commencing with Section 23701) of this chapter may be revoked by the Franchise Tax Board if the organization fails to—

(a) File any return required under this chapter or pay any amount due under this part or Part 10.2 (commencing with Section 18401) on or before the last day of the 12th month following the close of the ~~income~~ *taxable* year;

(b) Comply with Section 19504 (relating to powers of the Franchise Tax Board to examine records and subpoena witnesses); or

(c) Confine its activities to those permitted by the section under which the exemption was granted.

SEC. 106. Section 23800 of the Revenue and Taxation Code is amended to read:

23800. (a) For any ~~income~~ *taxable* year beginning on or after January 1, 1987, Subchapter S of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to the tax treatment of ''S corporations'' and their shareholders, shall apply, except as otherwise provided.

(b) For ~~income~~ *taxable* years beginning in 1987 and 1988, reasonable extensions of time may be granted, as appropriate for implementation of this chapter, in the form and the manner as the Franchise Tax Board may prescribe.

SEC. 107. 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~~ *taxable* years beginning in 1987, the following shall apply:

(A) A corporation that has in effect a valid federal election for the ~~income~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *a taxable* 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~~ *taxable* 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~~ *a taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *a taxable* year beginning in 1990, two and one-half months after qualifying to do business in California.

(II) For ~~an income~~ *a taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* year.

(5) For ~~income~~ *taxable* 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~~ *a taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* years beginning on or after January 1, 1997, for purposes of subparagraph (F) of paragraph (4) of subdivision (a) of this section and Section 1362(g) of the Internal Revenue Code, relating to election after termination, any termination under Section 1362(d) of the Internal Revenue Code or election to be treated as a ''C corporation'' under subparagraph (A) or (C) of paragraph (4) of subdivision (a), or to terminate by revocation under paragraph (3) of subdivision (f) in ~~an income~~ *a taxable* year beginning before January 1, 1997, shall not be taken into account.

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

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

each subsequent year until terminated, if both of the following conditions are met:

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

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

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

SEC. 108. Section 23802.5 of the Revenue and Taxation Code is amended to read:

23802.5. (a) For ~~income~~ *taxable* years beginning on or after January 1, 1997, Section 1366(a)(1) of the Internal Revenue Code, relating to determination of shareholder's tax liability, is modified to apply to the final taxable year of a trust or estate which terminates before the end of the corporation's ~~income~~ *taxable* year.

(b) For ~~income~~ *taxable* years beginning on or after January 1, 1997, Section 1366(d)(1)(A) of the Internal Revenue Code, relating to losses and deductions that cannot exceed shareholder's basis in stock and debt, is modified to additionally provide that the adjusted basis of a shareholder's stock in the S corporation is to be decreased by distributions by the corporation that were

not includable in the income of the shareholder by reason of Section 1368 of the Internal Revenue Code.

(c) For ~~income~~ *taxable* years beginning on or after January 1, 1997, Section 1366(d)(3) of the Internal Revenue Code, relating to carryover of disallowed losses and deductions to post-termination transition period, is modified to provide that to the extent that any increase in adjusted basis described in Section 1366(d)(3)(B) of the Internal Revenue Code would have increased the shareholder's amount at risk under Section 465 if the increase had occurred on the day preceding the commencement of the post-termination transition period, rules similar to the rules described in Section 1366(d)(3)(A) to (C), inclusive, of the Internal Revenue Code shall apply to any losses disallowed by reason of Section 465(a) of the Internal Revenue Code.

SEC. 109. Section 23803 of the Revenue and Taxation Code is amended to read:

23803. (a) (1) With respect to credits which are otherwise allowed to reduce the taxes imposed under this part:

(A) The amount of any credit to be claimed shall be limited to one-third of the amount otherwise allowable.

(B) (i) Any unused portion of the credit allowable under subparagraph (A) (one-third of the total credit) shall be allowed to be carried forward and shall not be subject to additional reductions under subparagraph (A) in later years.

(ii) No carryforward shall be allowed for the portion of the credit denied under subparagraph (A) (two-thirds of the total credit).

(C) Credits carried forward from ~~income~~ *taxable* years beginning prior to the first ~~income~~ *taxable* year in which the corporation is treated as an ''S corporation'' under this part, shall be reduced in accordance with subparagraph (A) for that first ~~income~~ *taxable* year and shall not be subject to additional reductions under subparagraph (A) in later years.

(D) The provisions of paragraphs (2) and (3) of subdivision (f) of Section 23802 shall be applied prior to the reduction required by subparagraph (A).

(E) No portion of any credit to which this paragraph applies shall be passed through to the shareholders of the ''S corporation.''

(F) The provisions of this paragraph shall not affect the amount of any credit computed under Part 10 (commencing with Section 17001) for pass through to shareholders in accordance with the provisions of Section 1366 of the Internal Revenue Code.

(2) With respect to credits which are allowed to the ''S corporation'' only because it is treated in the same manner as an individual, the provisions of Section 1366(a) of the Internal Revenue Code shall be modified to provide that the shareholder's pro rata share of the corporation's credits shall include the credit for political contributions allowed under Section 17053.14.

(b) Section 1366(f) of the Internal Revenue Code, relating to special rules, shall be modified as follows:

(1) The amount of tax used to compute the reduction allowed by Section 1366(f)(2) shall be the amount of tax imposed on built-in gains under this part.

(2) The amount of tax used to compute the reduction allowed by Section 1366(f)(3) shall be the amount of tax imposed on excess net passive income under this part.

SEC. 110. Section 23804.5 of the Revenue and Taxation Code is amended to read:

23804.5. For ~~income~~ *taxable* years beginning on or after January 1, 1997:

(a) Section 1368(d) of the Internal Revenue Code, relating to certain adjustments taken into account, is modified to provide that in the case of any distribution made during any ~~income~~ *taxable* year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in Section 1367(a)(1) of the Internal Revenue Code.

(b) Section 1368(e)(1) of the Internal Revenue Code, relating to accumulated adjustments account, is modified to provide as follows:

(1) In applying Section 1368 of the Internal Revenue Code to distributions made during any ~~income~~ *taxable* year, the amount in the accumulated adjustments account as of the close of the ~~income~~ *taxable* year shall be determined without regard to any net negative adjustment for that ~~income~~ *taxable* year.

(2) For purposes of paragraph (1), the term ''net negative adjustment'' means, with respect to any ~~income~~ *taxable* year, the excess, if any, of the reduction in the account for the ~~income~~ *taxable* year, other than for distributions, over the increase in that account for that ~~income~~ *taxable* year.

(3) Section 1368(e)(1)(A) of the Internal Revenue Code shall be modified to take into account the provisions of this subdivision.

(4) Section 1368(e)(1)(A) of the Internal Revenue Code shall be modified to refer to Section 1367(a)(2) of the Internal Revenue Code in lieu of Section 1367(b)(2)(A) of the Internal Revenue Code.

SEC. 111. Section 23806 of the Revenue and Taxation Code is amended 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~~ *a taxable* year beginning on or after January 1, 1997.

(2) Subdivision (c) shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1997.

SEC. 112. Section 23811 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

(e) (1) In the case of a corporation which elects to be treated as an ''S corporation'' for purposes of this part for

its first ~~income~~ *taxable* year beginning in 1987, or for its first ~~income~~ *taxable* year for which it has in effect a valid federal S election, there shall be allowed as a deduction in determining that corporation's subchapter C earnings and profits at the close of any ~~income~~ *taxable* year the amount of any consent dividend (as provided in paragraph (2)) paid after the close of that ~~income~~ *taxable* year.

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

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

(4) The collection of tax imposed by this section from a corporation described in paragraph (2) shall be stayed for 120 days after the date of the determination specified in paragraph (2). If a claim is filed pursuant to paragraph

(3), collection of that tax shall be further stayed until the date the claim is acted upon by the Franchise Tax Board.

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

SEC. 113. Section 24273 of the Revenue and Taxation Code is amended to read:

24273. (a) Amounts received as loans from the Commodity Credit Corporation shall, at the election of the taxpayer, be considered as income and shall be included in gross income for the ~~income~~ *taxable* year in which received.

(b) If a taxpayer exercises the election provided for in subsection (a) for any ~~income~~ *taxable* year, then the method of computing income so adopted shall be adhered to with respect to all subsequent ~~income~~ *taxable* years unless with the approval of the Franchise Tax Board a change to a different method is authorized.

SEC. 114. Section 24273.5 of the Revenue and Taxation Code is amended to read:

24273.5. (a) Noncash patronage allocations from farmers' cooperative and mutual associations (whether paid in capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice or in some other manner that discloses the dollar amount of such noncash patronage allocations) may, at the election of the taxpayer, be considered as income and included in gross income for the ~~income~~ *taxable* year in which received.

(b) If a taxpayer exercises the election provided for in subdivision (a), the amount included in gross income shall be the face amount of such allocations.

(c) If a taxpayer elects to exclude noncash patronage allocations from gross income for the ~~income~~ *taxable* year in which received, such allocations shall be included in gross income in the year that they are redeemed or realized upon.

(d) If a taxpayer exercises the election provided for in subdivision (c), the face amount of such noncash patronage allocations shall be disclosed in the return made for the ~~income~~ *taxable* year in which such noncash patronage allocations were received.

(e) If a taxpayer exercises the election provided for in subdivision (a) or (c) for any ~~income~~ *taxable* year, then the method of computing income so adopted shall be adhered to with respect to all subsequent ~~income~~ *taxable* years unless with the approval of the Franchise Tax Board a change to a different method is authorized.

(f) If a taxpayer has made the election provided for in subdivision (c), then (1) the statutory period for the assessment of a deficiency for any ~~income~~ *taxable* year in which the amount of any noncash patronage allocations are realized shall not expire prior to the expiration of four years from the date the Franchise Tax Board is notified by the taxpayer (in any manner as the Franchise Tax Board may by regulation prescribe) of the realization of gain on such allocations; and (2) that deficiency may be assessed prior to the expiration of the four-year period, notwithstanding the provisions of Section 19057 or the provisions of any other law or rule of law which would otherwise prevent such assessment.

SEC. 115. Section 24275 of the Revenue and Taxation Code is amended to read:

24275. In the case of any taxpayer who is required to include the amount of any nuclear decommissioning costs in the taxpayer's cost of service for ratemaking purposes, there shall be includable in the gross income of that taxpayer the amount so included for any ~~income~~ *taxable* year.

SEC. 116. Section 24276 of the Revenue and Taxation Code is amended to read:

24276. Section 90 of the Internal Revenue Code, relating to illegal federal irrigation subsidies, shall apply to water delivered to the taxpayer on or after January 1, 1988, in ~~income~~ *taxable* years beginning on or after January 1, 1989, except as otherwise provided.

SEC. 117. Section 24306 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

SEC. 118. Section 24307 of the Revenue and Taxation Code is amended to read:

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

(b) Section 108(b)(2)(B) of the Internal Revenue Code, relating to general business credit, is modified by

substituting ''this part'' in lieu of ''Section 38 (relating to general business credit).''

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

(d) Section 108(b)(3)(B) of the Internal Revenue Code, relating to credit carryover reduction, is modified by substituting ''11.1 cents'' in lieu of ''33 $^{1}/_{3}$ cents'' in each place in which it appears. In the case where more than one credit is allowable under this part, the credits shall be reduced on a pro rata basis.

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

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

(2) If a taxpayer makes an election for federal income tax purposes under Section 108(c) of the Internal Revenue Code, relating to treatment of discharge of qualified real property business indebtedness, a separate election shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5 and the federal election shall be binding for purposes of this part.

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

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

1996, in ~~income~~ *taxable* years beginning on or after January 1, 1996.

SEC. 119. Section 24308 of the Revenue and Taxation Code is amended to read:

24308. Section 1078 of Public Law 98-369 (Tax Reform Act of 1984), relating to exclusions from gross income of payments from the United States Forest Service as a result of restricting motorized traffic in the Boundary Waters Canoe Area, shall apply, with the following exceptions:

(a) Section 1078(f)(2) of that act shall not be applicable.

(b) This section shall be effective only for payments made in ~~income~~ *taxable* years beginning on or after January 1, 1985.

SEC. 120. Section 24322 of the Revenue and Taxation Code is amended to read:

24322. (a) Gross income of a domestic building and loan association, as defined in Section 7701(a)(19) of the Internal Revenue Code, does not include any amount of money or other property received from the Federal Savings and Loan Insurance Corporation pursuant to Section 406(f) of the National Housing Act (12 U.S.C. Section 1729(f)), regardless of whether any note or other instrument is issued in exchange therefor.

(b) No reduction in the basis of assets of a domestic building and loan association shall be made on account of money or other property received under the circumstances referred to in subdivision (a).

(c) Section 24425 shall not deny any deductions by reason of the deductions being allocable to amounts excluded from gross income under this section.

(d) This section shall not apply with respect to any amounts excludable under subdivision (a) received after December 31, 1988, in ~~income~~ *taxable* years ending after that date, unless the payments are made by the Federal Savings and Loan Insurance Corporation pursuant to an acquisition or merger which occurred on or before December 31, 1988.

SEC. 121. Section 24324 of the Revenue and Taxation Code is amended to read:

24324. (a) Gross income does not include any contribution to the capital of the taxpayer.

(b) (1) For purposes of this section, ‘‘contribution to the capital of the taxpayer’’ includes any amount of money or other property received from any person (whether or not a shareholder) by a regulated public utility that provides electric energy, gas (through a local distribution system or transportation by pipeline), water, or sewerage disposal services if all of the following apply:

(A) The amount is contribution in aid of construction.

(B) Where the contribution is in property that is other than electric energy, gas steam, water, or sewerage disposal facilities, the amount meets the requirements of the expenditure rule of paragraph (2).

(C) The amounts (or any property acquired or constructed with those amounts) are not included in the taxpayer’s rate base for ratemaking purposes.

(2) An amount meets the requirements of this paragraph if all of the following apply:

(A) An amount equal to that amount is expended for the acquisition or construction of tangible property described in Section 1231(b) of the Internal Revenue Code and both of the following apply:

(i) The expenditure was the purpose motivating the contribution.

(ii) The property is used predominantly in the trade or business of furnishing electric energy, gas, steam, water, or sewerage disposal services.

(B) The expenditure referred to in subparagraph (A) occurs before the end of the second ~~income~~ *taxable* year after the ~~income~~ *taxable* year in which that amount was received.

(C) Accurate records are kept of the amount contributed and expenditures made on the basis of the project for which the contribution was made and on the basis of the year of contribution or expenditure.

(3) For purposes of this section:

(A) ‘‘Contribution in aid of construction’’ does not include amounts paid as customer connection fees (including amounts paid to connect the customer’s line to an electric line, a gas main, a steam line, or a main water or sewer line) and amounts paid as service charges for starting or stopping services.

(B) ‘‘Contribution in aid of construction’’ includes amounts received by a regulated public utility from a contributor to recover the federal tax imposed upon contributions in aid of construction, provided that the method used to recover the tax is authorized by Public Utilities Commission Decision 87-09-026.

(C) ‘‘Predominantly’’ means 80 percent or more.

(D) ‘‘Regulated public utility’’ means a regulated public utility as defined by Section 7701(a)(33) of the Internal Revenue Code, except that it does not include any utility which is not required to provide electric energy, gas, water, or sewerage disposal services to members of the general public (including, in the case of a gas transmission utility, the provision of gas services by sale for resale to the general public) in its service area.

(4) Notwithstanding any other provision of this part, no deduction or credit shall be allowed for, or by reason of, the expenditure which constitutes a contribution in aid of construction to which this section applies. The adjusted basis of any property acquired with contributions in aid of construction to which this section applies shall be zero.

(c) This section shall apply to contributions in aid of construction made on or after January 1, 1977, and before January 1, 1992.

SEC. 122. Section 24343.3 of the Revenue and Taxation Code is amended to read:

24343.3. Any employer contribution to a medical savings account, as defined in Section 220 of the Internal Revenue Code, relating to medical savings accounts, if otherwise deductible under this part, shall be allowed only for the ~~income~~ *taxable* year in which paid.

SEC. 123. Section 24343.5 of the Revenue and Taxation Code is amended to read:

24343.5. (a) In addition to the deduction allowed by Section 24343, a deduction shall be allowed to an employer as an ordinary and necessary expense paid or incurred during the ~~income~~ *taxable* year in carrying on any trade or business for those expenses involved in any of the following ridesharing arrangements:

(1) Subsidizing employees commuting in vanpools.

(2) Subsidizing employees commuting in private commuter buses or buspools.

(3) Subsidizing monthly transit passes for its employees or for use by the employee's dependents, except that no deduction shall be allowed for transit passes issued for the use of elementary and secondary school students.

(4) Subsidizing employees commuting in subscription taxipools.

(5) Subsidizing employees commuting in a carpool.

(6) In the case of an employer who offers free parking to its employees, offering a cash equivalent to employees who do not require parking, including a parking cash-out program, as defined by subdivision (f) of Section 65088.1 of the Government Code.

(7) Providing free or preferential parking to carpools, vanpools, or any other vehicle used in a ridesharing arrangement.

(8) Making facility improvements to encourage employees, for the purpose of commuting from their homes, to participate in ridesharing arrangements, to use bicycles, or to walk. These facility improvements may include, but are not limited to, any of the following: the construction of bus shelters; the installation of bicycle racks and other bicycle-related facilities, such as showers and locker rooms; and parking lot modifications to provide carpools, vanpools, or buspools with preferential treatment. The cost of these facility improvements shall be allowed as a depreciation deduction. Notwithstanding subdivision (c), the depreciation deduction shall be allowable over a 36-month period.

(9) Providing company commuter van or bus service to its employees and to others for commuting from their

homes, but not for transportation required as part of the employer's business activities, except as otherwise provided in this section. The capital costs of providing this service shall not be an eligible deduction under this section.

(10) Providing to employees transportation services which are required as part of the employer's business activities to the extent that the transportation would be provided by employees without reimbursement in the absence of an employer-sponsored ridesharing incentive program. The capital costs of providing this service shall not be an eligible deduction under this section.

(b) For purposes of this section:

(1) ''Employer'' means either of the following:

(A) A taxpayer for whom services are performed by employees, except entities which are not subject to tax under this part.

(B) A taxpayer which is a private or public educational institution which enrolls students at higher than the secondary level.

(2) ''Employee'' means either of the following:

(A) An individual who performs service for an employer for more than eight hours per week for remuneration.

(B) Any commuting student, as defined in paragraph (3).

(3) ''Commuting student'' means a registered full-time student at a college, university, or other postsecondary educational institution, who lives apart from the property which is designated as the ''employment site'' for the purpose of this section, and who travels between his or her residence and the designated employment site on a regular, though not necessarily daily, basis.

(4) ''Employer-sponsored ridesharing incentive program'' means a program undertaken by an employer either alone or in cooperation with other employers to encourage or provide, or both, fiscal other incentives to employees to make the home-to-work commute trip by any mode other than the single-occupant motor vehicle.

(5) ‘‘Company commuter bus or van’’ means a highway vehicle which meets all of the following criteria:

(A) Has at least seven or more persons commuting on a daily basis to and from work.

(B) At least 50 percent of the mileage of which can be reasonably expected to be used for the purpose of transporting employees to and from work.

(C) Is acquired by the taxpayer on or after the date of enactment of this legislation.

(6) ‘‘Vanpool’’ means seven or more persons commuting on a daily basis to and from work by means of a vehicle with a seating arrangement designed to carry 7 to 15 adult persons.

(7) ‘‘Monthly transit pass’’ means any bulk purchase of transit rides that entitles the purchaser to 40 or more rides per month, whether at a discount rate or the base fare rate.

(8) ‘‘Transit’’ means transportation service for use by the general public that utilizes buses, railcars, or ferries with a seating capacity of 16 or more persons.

(9) ‘‘Subscription taxipool’’ means a type of service in which employers or groups of employees contract with a public or private taxi operator to provide daily commuter service for a group of preassembled subscribers on a prepaid or daily-fare basis, following a relatively fixed route and schedule tailored to meet the needs of the subscribers.

(10) ‘‘Ridesharing arrangement’’ means the transportation of persons in a motor vehicle where that transportation is incidental to another purpose of the driver. The term includes ridesharing arrangements known as carpools, vanpools, and buspools.

(11) ‘‘Carpool’’ means two or more persons commuting on a daily basis to and from work by means of a vehicle with a seating arrangement designed to carry less than seven adults, including the driver.

(12) ‘‘Buspool’’ means 16 or more persons commuting on a daily basis to and from work by means of a vehicle with a seating arrangement designed to carry more than 15 adult passengers.

(13) ‘‘Private commuter bus’’ means a highway vehicle which meets all of the following criteria:

(A) Has a seating capacity of at least seven adults, including the driver.

(B) At least 50 percent of the mileage of which can be reasonably expected to be used for the purpose of transporting employees to and from work.

(C) Is acquired by the taxpayer on or after the date of enactment of this section.

(D) With respect to which the taxpayer makes an election under this paragraph on its return for the ~~income~~ *taxable* year in which the vehicle is placed in service.

SEC. 124. Section 24343.7 of the Revenue and Taxation Code is amended to read:

24343.7. (a) Section 162(e) of the Internal Revenue Code, relating to the denial of deduction for certain lobbying and political expenditures, shall not apply.

(b) (1) The deduction allowed by Section 162(a) of the Internal Revenue Code, relating to trade or business expenses, shall include all the ordinary and necessary expenses, including, but not limited to, traveling expenses described in Section 162(a)(2) of the Internal Revenue Code and the cost of preparing testimony, paid or incurred during the ~~income~~ *taxable* year in carrying on any trade or business for any of the following:

(A) In direct connection with appearances before, submission of statements to, or sending communications to, the committees, or individual members, of Congress or of any legislative body of a state, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer.

(B) In direct connection with communication of information between the taxpayer and an organization of which the taxpayer is a member with respect to legislation or proposed legislation of direct interest to the taxpayer and to that organization.

(C) That portion of the dues so paid or incurred with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the

activities described in subparagraphs (A) and (B) carried on by that organization.

(2) Paragraph (1) shall not be construed as allowing the deduction of any amount paid or incurred, whether by way of contribution, gift, or otherwise, with respect to either of the following:

(A) For participation in, or intervention in, any political campaign on behalf of any candidate for public office.

(B) In connection with any attempt to influence the general public, or segments thereof, with respect to legislative matters, elections, or referendums.

(c) Section 162(m) of the Internal Revenue Code, relating to certain excessive employee remuneration, shall not apply.

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

SEC. 125. Section 24344 of the Revenue and Taxation Code is amended to read:

24344. (a) Section 163 of the Internal Revenue Code, relating to interest, shall apply, except as otherwise provided.

(b) If income of the taxpayer which is derived from or attributable to sources within this state is determined pursuant to Section 25101 or 25110, the interest deductible shall be an amount equal to interest income subject to apportionment by formula, plus the amount, if any, by which the balance of interest expense exceeds interest and dividend income (except dividends deductible under Section 24402 and dividends subject to the deductions provided for in Section 24411 to the extent of those deductions) not subject to apportionment by formula. Interest expense not included in the preceding sentence shall be directly offset against interest and dividend income (except dividends deductible under Section 24402 and dividends subject to the deductions provided for in Section 24411 to the extent of those deductions) not subject to apportionment by formula.

(c) (1) Notwithstanding subdivision (b) and subject to paragraph (2), interest expense allowable under

Section 163 of the Internal Revenue Code that is incurred for purposes of foreign investments may be offset against dividends deductible under Section 24411.

(2) For ~~income~~ *taxable* years beginning on or after January 1, 1997, the amount of interest computed pursuant to paragraph (1) shall be multiplied by the same percentage used to determine the dividend deduction under Section 24411 to determine that amount of interest that may be offset as provided in paragraph (1).

(d) Section 7210(b) of Public Law 101-239, relating to the effective date for limitation on deduction for certain interest paid to a related person, shall apply.

(e) Section 163(j)(6)(C) of the Internal Revenue Code, relating to treatment of an affiliated group, is modified to apply to all members of a combined report filed under Section 25101.

SEC. 126. Section 24344.5 of the Revenue and Taxation Code is amended to read:

24344.5. (a) A deduction, determined in accordance with Section 163(e) of the Internal Revenue Code, shall be allowed to the issuer of an original issue discount bond.

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

(c) The difference between the amount deductible on the federal tax return and the amount allowable under this part, with respect to obligations issued after December 31, 1984, for ~~income~~ *taxable* years beginning before January 1, 1987, shall be allowed as a deduction in the ~~income~~ *taxable* year in which the debt obligation matures or is sold, exchanged, or otherwise disposed.

(d) The provisions of Section 7202(c) of Public Law 101-239, relating to the effective date for treatment of certain high yield original issue discount obligations, shall apply.

SEC. 127. Section 24344.7 of the Revenue and Taxation Code is amended to read:

24344.7. The amendments to Section 163 of the Internal Revenue Code made by Section 13228 of the Revenue Reconciliation Act of 1993 (P.L. 103-66), relating to modification to limitation on deduction for certain interest, shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1996.

SEC. 128. Section 24345 of the Revenue and Taxation Code is amended to read:

24345. A deduction shall be allowed for taxes or licenses paid or accrued during the ~~income~~ *taxable* year, except:

(a) Taxes paid to the state under this part.

(b) Taxes on or according to or measured by income or profits paid or accrued within the ~~income~~ *taxable* year imposed by the authority of any of the following:

(1) The Government of the United States or any foreign country.

(2) Any state, territory, county, school district, municipality, or other taxing subdivision of any state or territory.

(c) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed, but this does not exclude the allowance as a deduction of so much of the taxes assessed against local benefits as is properly allocable to maintenance or interest charges. Nor does this exclude the allowance of any irrigation or other water district taxes or assessments which are levied for the payment of the principal of any improvement or other bonds for which a general assessment on all lands within the district is levied as distinguished from a special assessment levied on part of the area within the district.

(d) Federal stamp taxes (not described in subdivision (b) or (c)); but this subdivision shall not prevent such taxes from being deducted under Section 24343 (relating to trade or business expenses).

(e) State and local general sales or use taxes. However, there shall be allowed as a deduction, state and local sales or use taxes which are paid or accrued within the ~~income~~ *taxable* year in carrying on a trade or business or an activity described in Section 212 of the Internal Revenue

Code (relating to expenses for production of income). Notwithstanding the preceding sentence, any sales or use tax (except where a tax credit is claimed under Section 23612.2) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

(f) For purposes of subdivision (b), ‘‘taxes on or according to or measure by income’’ shall include any taxes imposed on a dividend that is eliminated from the income of the recipient under Section 25106.

SEC. 129. Section 24346 of the Revenue and Taxation Code is amended to read:

24346. (a) For purposes of subdivision (a) of Section 24345, if real property is sold during any real property tax year, then—

(1) So much of the real property tax as is properly allocable to that part of the year which ends on the day before the date of the sale shall be treated as a tax imposed on the seller; and

(2) So much of that tax as is properly allocable to that part of the year which begins on the date of the sale shall be treated as a tax imposed on the purchaser.

(b) (1) In the case of any sale of real property; if—

(A) A corporation may not, by reason of its method of accounting, deduct any amount for taxes unless paid; and

(B) The other party to the sale is (under the law imposing the real property tax) liable for the real property tax for the real property tax year;

then for purposes of subdivision (a) of Section 24345 the corporation shall be treated as having paid, on the date of the sale, so much of the tax as, under subdivision (a), is treated as imposed on the corporation. For purposes of the preceding sentence, if neither party is liable for the tax, then the party holding the property at the time the tax becomes a lien on the property shall be considered liable for the real property tax for the real property tax year.

(2) Subdivision (a) shall apply to ~~income~~ *taxable* years beginning after December 31, 1960, but only in the case of sales after December 31, 1960.

(3) Subdivision (a) shall not apply to any real property tax, to the extent that the tax was allowable as a deduction under the Bank and Corporation Tax Law of 1954 to the seller for ~~an income~~ *a taxable* year which began before January 1, 1961.

(4) In the case of any sale of real property, if the corporation's net income for the ~~income~~ *taxable* year during which the sale occurs is computed under an accrual method of accounting, and if no election under subdivision (b) of Section 24681 (relating to the accrual of real property taxes) applies, then, for purposes of subdivision (a) of Section 24345, that portion of the tax that—

(A) Is treated, under subdivision (a), as imposed on the corporation; and

(B) May not, by reason of the corporation's method of accounting, be deducted by the corporation for any ~~income~~ *taxable* year, shall be treated as having accrued on the date of the sale.

SEC. 130. Section 24347 of the Revenue and Taxation Code is amended to read:

24347. For ~~income~~ *taxable* years beginning on or after January 1, 1990, all of the following shall apply:

(a) Section 165 of the Internal Revenue Code, relating to losses.

(b) Section 166 of the Internal Revenue Code, relating to bad debts, except that the deduction of a savings and loan association, bank or financial corporation shall be determined under Section 24348.

(c) (1) Section 582 of the Internal Revenue Code, relating to bad debts, losses, and gains with respect to securities held by financial institutions.

(2) Section 582(c)(2)(C) of the Internal Revenue Code, relating to limitations on foreign banks, but only to foreign corporations that have in effect for the ~~income~~ *taxable* year a water's edge election under Section 25110.

SEC. 131. Section 24347.5 of the Revenue and Taxation Code is amended to read:

24347.5. (a) An excess disaster loss, as defined in subdivision (c), shall be carried to other ~~income~~ *taxable* years as provided in subdivision (b), with respect to losses resulting from any of the following disasters:

(1) Forest fire or any other related casualty occurring in 1985 in California.

(2) Storm, flooding, or any other related casualty occurring in 1986 in California.

(3) Any loss sustained during 1987 as a result of a forest fire or any other related casualty.

(4) Earthquake, aftershock, or any other related casualty occurring in October 1987 in California.

(5) Earthquake, aftershock, or any other related casualty occurring in October 1989 in California.

(6) Any loss sustained during 1990 as a result of fire or any other related casualty in California.

(7) Any loss sustained as a result of the Oakland/Berkeley Fire of 1991, or any other related casualty.

(8) Any loss sustained as a result of storm, flooding, or any other related casualty occurring in February 1992 in California.

(9) Earthquake, aftershock, or any other related casualty occurring in April 1992 in the County of Humboldt.

(10) Riots, arson, or any other related casualty occurring in April or May 1992 in California.

(11) Any loss sustained as a result of the earthquakes or any other related casualty that occurred in the County of San Bernardino in June and July of 1992.

(12) Any loss sustained as a result of the Fountain Fire that occurred in the County of Shasta, or as a result of either of the fires in the Counties of Calaveras and Trinity that occurred in August 1992, or any other related casualty.

(13) Any loss sustained as a result of storm, flooding, or any other related casualty that occurred in the Counties of Alpine, Contra Costa, Fresno, Humboldt, Imperial,

Lassen, Los Angeles, Madera, Mendocino, Modoc, Monterey, Napa, Orange, Plumas, Riverside, San Bernardino, San Diego, Santa Barbara, Sierra, Siskiyou, Sonoma, Tehama, Trinity, and Tulare, and the City of Fillmore in January 1993.

(14) Any loss sustained as a result of a fire that occurred in the Counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura, during October or November of 1993, or any other related casualty.

(15) Any loss sustained as a result of the earthquake, aftershocks, or any other related casualty that occurred in the Counties of Los Angeles, Orange, and Ventura on or after January 17, 1994.

(16) Any loss sustained as a result of a fire that occurred in the County of San Luis Obispo during August of 1994, or any other related casualty.

(17) Any loss sustained as a result of the storms or flooding occurring in 1995, or any other related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms and flooding.

(18) Any loss sustained as a result of the storms or flooding occurring in December 1996 or January 1997, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms or flooding.

(19) Any loss sustained as a result of the storms or flooding occurring in February 1998, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms or flooding.

(20) Any loss sustained as a result of a freeze occurring in the winter of 1998–99, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the freeze.

(b) (1) In the case of any loss allowed under Section 165 of the Internal Revenue Code, relating to losses, any excess disaster loss shall be carried forward to each of the five ~~income~~ *taxable* years following the ~~income~~ *taxable* year for which the loss is claimed. However, if there is any

excess disaster loss remaining after the five-year period, then 50 percent of that excess disaster loss shall be carried forward to each of the next 10 ~~income~~ *taxable* years.

(2) The entire amount of any excess disaster loss as defined in subdivision (c) shall be carried to the earliest of the ~~income~~ *taxable* years to which, by reason of subdivision (b), the loss may be carried. The portion of the loss which shall be carried to each of the other ~~income~~ *taxable* years shall be the excess, if any, of the amount of excess disaster loss over the sum of the net income for each of the prior ~~income~~ *taxable* years to which that excess disaster loss is carried.

(c) ''Excess disaster loss'' means a disaster loss computed pursuant to Section 165 of the Internal Revenue Code, which exceeds the net income of the year of loss or, if the election under Section 165(i) of the Internal Revenue Code is made, the net income of the year preceding the loss.

(d) The provisions of this section and Section 165(i) of the Internal Revenue Code shall be applicable to any of the losses listed in subdivision (a) sustained in any county or city in this state which was proclaimed by the Governor to be in a state of disaster.

(e) Any corporation subject to the provisions of Section 25101 or 25101.15 that has disaster losses pursuant to this section, shall determine the excess disaster loss to be carried to other ~~income~~ *taxable* years under the principles specified in Section 25108 relating to net operating losses.

(f) Losses allowable under this section may not be taken into account in computing a net operating loss deduction under Section 172 of the Internal Revenue Code.

(g) For losses described in paragraphs (15), (16), (17), (18), (19), and (20) of subdivision (a), the election under Section 165(i) of the Internal Revenue Code may be made on a return or amended return filed on or before the due date of the return (determined with regard to extension) for the ~~income~~ *taxable* year in which the disaster occurred.

SEC. 132. Section 24348 of the Revenue and Taxation Code is amended to read:

24348. (a) (1) There shall be allowed as a deduction either of the following:

(A) Debts which become worthless within the ~~income~~ *taxable* year in an amount not in excess of the part charged off within that ~~income~~ *taxable* year.

(B) In the case of a savings and loan association, bank, or financial corporation, in lieu of any deduction under subparagraph (A), in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for bad debts.

(2) When satisfied that a debt is recoverable in part only the Franchise Tax Board may allow that debt, in an amount not in excess of the part charged off within the ~~income~~ *taxable* year, as a deduction; provided, however, that if a portion of a debt is claimed and allowed as a deduction in any year no deduction shall be allowed in any subsequent year for any portion of the debt which in any prior year was charged off, regardless of whether claimed as a deduction in that prior year.

(b) (1) The amendments to this section made during the 1985–86 Regular Session by the act adding this subdivision shall apply only to ~~income~~ *taxable* years beginning after December 31, 1987.

(2) In the case of any taxpayer who maintained a reserve for bad debts for that taxpayer's last ~~income~~ *taxable* year beginning before January 1, 1988, and who is required by the amendments to this section to change its method of accounting for any ~~income~~ *taxable* year, all of the following shall apply:

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

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

(C) The net amount of adjustments required by Article 6 (commencing with Section 24721) of Chapter 13, to be taken into account by the taxpayer shall:

(i) In the case of a taxpayer maintaining a reserve under former subdivision (b) (prior to the amendments made during the 1985–86 Regular Session by the act

adding this subdivision), be reduced by the balance in the suspense account under paragraph (4) of that subdivision as of the close of such last ~~income~~ *taxable* year; and

(ii) Be taken into account ratably in each of the first four ~~income~~ *taxable* years beginning after December 31, 1987.

SEC. 133. 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~~ *taxable* years ending after December 31, 1958, the term ‘‘reasonable allowance’’ as used in subdivision (a) shall include, but shall not be limited to, an allowance computed in accordance with regulations prescribed by the Franchise Tax Board, under any of the following methods:

(1) The straight-line method.

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

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

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

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

(c) Any grapevine replaced in a vineyard in California in ~~an income~~ *a taxable* year beginning on or after January

1, 1992, as a direct result of a phylloxera infestation in that vineyard, and any grapevine replaced in a vineyard in California in ~~an income~~ *a taxable* year beginning on or after January 1, 1997, as a direct result of Pierce's Disease in that vineyard, shall have a useful life of five years, except that it shall have a class life of 10 years for purposes of depreciation under Section 168(g)(2) of the Internal Revenue Code where the taxpayer has made an election under Section 263A(d)(3) of the Internal Revenue Code not to capitalize costs of the infested vineyard. Every taxpayer claiming a deduction under this section with respect to a grapevine as described in this subdivision shall obtain a written certification from an independent state-certified integrated pest management adviser, or a state agricultural commissioner or adviser, that specifies that the replanting was necessary to restore a vineyard infested with phylloxera or Pierce's Disease. The taxpayer shall retain the certification for future audit purposes.

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

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

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

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

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

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

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

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

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

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

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

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

(3) Section 167(g)(5)(D) of the Internal Revenue Code is modified by substituting ‘‘Part 10.2 (commencing with Section 18401) (other than Article 2 (commencing with Section 19021) and Sections 19142 to 19150, inclusive)’’ in lieu of ‘‘Subtitle F (other than Sections 6654 and 6655).’’

SEC. 134. Section 24351 of the Revenue and Taxation Code is amended to read:

24351. Where, under regulations prescribed by the Franchise Tax Board, the taxpayer and the Franchise Tax Board have, after the date of enactment of this section, entered into an agreement in writing specifically dealing

with the useful life and rate of depreciation of any property, the rate so agreed upon shall be binding on both the taxpayer and the Franchise Tax Board in the absence of facts or circumstances not taken into consideration in the adoption of such agreement. The responsibility of establishing the existence of such facts and circumstances shall rest with the party initiating the modification. Any change in the agreed rate and useful life specified in the agreement shall not be effective for ~~income~~ *taxable* years before the ~~income~~ *taxable* year in which notice in writing by certified mail or registered mail is served by the party to the agreement initiating such change.

SEC. 135. Section 24354.1 of the Revenue and Taxation Code is amended to read:

24354.1. (a) Except as provided in subdivisions (b) and (c) of this section, in the case of property of the type defined in Section 1250(c) of the Internal Revenue Code, subdivision (b) of Section 24349 shall not apply and the term ‘‘reasonable allowance’’ as used in subdivision (a) of Section 24349 shall include 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 150 percent of the rate which would have been used had the annual allowance been computed under the method described in paragraph (1), or

(3) Any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer’s use of the property and including the ~~income~~ *taxable* year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such 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) of Section 24349 except where allowable

solely by reason of paragraph (2), (3), or (4) of subdivision (b) of Section 24349.

(b) (1) Subdivision (a) of this section shall not apply, and subdivision (b) of Section 24349 shall apply in any ~~income~~ *taxable* year, to a building or structure—

(A) Which is residential rental property located within the United States or any of its possessions, or located within a foreign country if a method of depreciation for such property comparable to the method provided in paragraph (2) or (3) of subdivision (b) of Section 24349 is provided by the laws of such country and

(B) The original use of which commences with the taxpayer. In the case of residential rental property located within a foreign country, the original use of which commences with the taxpayer, if the allowance for depreciation provided under the laws of such country for such property is greater than that provided under subdivision (a) of this section, but less than that provided under subdivision (b) of Section 24349, the allowance for depreciation under subdivision (b) of Section 24349 shall be limited to the amount provided under the laws of such country.

(2) For purposes of paragraph (1), a building or structure shall be considered to be residential rental property for any ~~income~~ *taxable* year only if 80 percent or more of the gross rental income from such building or structure for such year is rental income from dwelling units (within the meaning of paragraph (3) of subdivision (c) of Section 24354.2. For purposes of the preceding sentence, if any portion of such building or structure is occupied by the taxpayer, the gross rental income from such building or structure shall include the rental value of the portion so occupied.

(3) Any change in the computation of the allowance for depreciation for any ~~income~~ *taxable* year, permitted or required by reason of the application of paragraph (1), shall not be considered a change in a method of accounting.

(c) Subdivision (a) of this section shall not apply, and subdivision (b) of Section 24349 shall apply, in the case of property—

(1) The construction, reconstruction, or erection of which was begun before January 1, 1971, or

(2) For which a written contract entered into before January 1, 1971, with respect to any part of the construction, reconstruction, or erection or for the permanent financing thereof, was on January 1, 1971, and at all times thereafter, binding on the taxpayer.

(d) Except as provided in subdivision (e), in the case of property of the type defined in Section 1250(c) of the Internal Revenue Code acquired after December 31, 1970, the original use of which does not commence with the taxpayer, the allowance for depreciation under Sections 24349 to 24354.2, inclusive, shall be limited to an amount computed under—

(1) The straight line method, or

(2) Any other method determined by the Franchise Tax Board to result in a reasonable allowance under subdivision (a) of Section 24349, not including—

(A) Any declining balance method,

(B) The sum of the years-digits method, or

(C) Any other method allowable solely by reason of the application of paragraph (4) of subdivision (b) of Section 24349 or paragraph (3) of subdivision (a) of this section.

(e) In the case of property of the type defined in Section 1250(c) of the Internal Revenue Code which is residential rental property (as defined in paragraph (2) of subdivision (b)) acquired after December 31, 1970, having a useful life of 20 years or more, the original use of which does not commence with the taxpayer, the allowance for depreciation under Sections 24349 to 24354.2, inclusive, shall be limited to an amount computed under—

(1) The straight line method,

(2) The declining balance method, using a rate not exceeding 125 percent of the rate which would have been

used had the annual allowance been computed under the method described in paragraph (1), or

(3) Any other method determined by the Franchise Tax Board to result in a reasonable allowance under subdivision (a) of Section 24349, not including—

(A) The sum of the years-digits method,

(B) Any declining balance method using a rate in excess of the rate permitted under paragraph (2), or

(C) Any other method allowable solely by reason of the application of paragraph (4) of subdivision (b) of Section 24349 or paragraph (3) of subdivision (a) of this section.

(f) (1) For purposes of subdivisions (b), (d), and (e), if property of the type defined in Section 1250(c) of the Internal Revenue Code which is not property described in subdivision (a) of Section 24349 when its original use commences, becomes property described in subdivision (a) of Section 24349 after December 31, 1970, such property shall not be treated as property the original use of which commences with the taxpayer.

(2) Subdivisions (d) and (e) shall not apply in the case of property of the type defined in Section 1250(c) of the Internal Revenue Code, acquired after December 31, 1970, pursuant to a written contract for the acquisition of such property or for the permanent financing thereof, which was, on December 31, 1970, and at all times thereafter, binding on the taxpayer.

(g) This section shall not apply to public utility property which means property used predominantly in the trade or business of the furnishing or sale of—

(1) Electrical energy, water, or sewage disposal services,

(2) Gas or steam through a local distribution system,

(3) Telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(4) Transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a state or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any state or political subdivision thereof.

SEC. 136. Section 24355.5 of the Revenue and Taxation Code is amended to read:

24355.5. (a) Section 197 of the Internal Revenue Code, relating to amortization of goodwill and certain other intangibles, shall apply, except as otherwise provided.

(b) (1) Section 13261(g) of the Revenue Reconciliation Act of 1993 (P.L. 103-66), relating to effective dates, shall apply, except as otherwise provided.

(2) (A) If a taxpayer has, at any time, made an election for federal purposes under Section 13261(g)(2) of the Revenue Reconciliation Act of 1993 (P.L. 103-66), relating to election to have amendments apply to property acquired after July 25, 1991, or Section 13261(g)(3) of that act, relating to elective binding contract exception, 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.

(B) If a taxpayer has not made an election for federal purposes under Section 13261(g)(2) of the Revenue Reconciliation Act of 1993 (P.L. 103-66), relating to election to have amendments apply to property acquired after July 25, 1991, or Section 13261(g)(3) of that act, relating to elective binding contract exception, with respect to property acquired before August 11, 1993, then the taxpayer shall not be allowed to make an election under Section 13261(g) of the Revenue Reconciliation Act of 1993 (P.L. 103-66), for purposes of this part, with respect to that property.

(c) Notwithstanding any other provision of this section, each of the following shall apply:

(1) No deduction shall be allowed under this section for any ~~income~~ *taxable* year beginning prior to January 1, 1994.

(2) No inference is intended with respect to the allowance or denial of any deduction for amortization in any ~~income~~ *taxable* year beginning before January 1, 1994.

(3) In the case of an intangible that was acquired in an ~~income~~ *taxable* year beginning before January 1, 1994, the amount to be amortized shall not exceed the adjusted basis of that intangible as of the first day of the first ~~income~~ *taxable* year beginning on or after January 1, 1994, and that amount shall be amortized ratably over the period beginning with the first month of the first ~~income~~ *taxable* year beginning on or after January 1, 1994, and ending 15 years after the month in which the intangible was acquired.

SEC. 137. Section 24356 of the Revenue and Taxation Code is amended to read:

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

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

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

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

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

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

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

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

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

(A) The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under Sections 24427 through 24429 (but, in applying Sections 24428 and 24429 for purposes of this section, paragraph (d) of Section 24429 shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants);

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

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

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

(4) For purposes of subsection (b) of this section—

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

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

(5) For purposes of paragraphs (2) and (4), the term ‘‘affiliated group’’ has the meaning assigned to it by Section 1504 of the Internal Revenue Code of 1954, except that, for such purposes, the phrase ‘‘more than 50 percent’’ shall be substituted for the phrase ‘‘at least 80 percent’’ each place it appears in Section 1504(a) of the Internal Revenue Code of 1954.

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

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

SEC. 138. Section 24356.5 of the Revenue and Taxation Code is amended to read:

24356.5. (a) Section 179A of the Internal Revenue Code, relating to deduction for clean-fuel vehicles and certain refueling property, shall apply to property placed in service after June 30, 1993, without regard to ~~income~~ *taxable* year, except as otherwise provided.

(b) Section 179A(e)(5) of the Internal Revenue Code, relating to property used outside the United States, is modified to also refer to Section 24356.4 or 24356.7.

(c) Section 179A(g) of the Internal Revenue Code, relating to termination, is modified to substitute ‘‘December 31, 1994’’ for ‘‘December 31, 2004.’’

SEC. 139. Section 24356.6 of the Revenue and Taxation Code is amended to read:

24356.6. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1998, a qualified taxpayer may elect to treat 40 percent of the cost of any Section 24356.6 property as an expense that is not chargeable to a capital account. Any cost so treated shall be allowed as a deduction for the ~~income~~ *taxable* year in which the qualified taxpayer places the Section 24356.6 property in service.

(b) (1) An election under this section for any ~~income~~ *taxable* year shall do both of the following:

(A) Specify the items of Section 24356.6 property to which the election applies and the percentage of the cost of each of those items that are to be taken into account under subdivision (a).

(B) Be made on the qualified taxpayer's original return of the tax imposed by this part for the ~~income~~ *taxable* year.

(2) Any election made under this section, and any specification contained in that election, may not be revoked except with the consent of the Franchise Tax Board.

(c) (1) For purposes of this section, ''Section 24356.6 property'' means any recovery property that is:

(A) Section 1245 property (as defined in Section 1245 (a)(3) of the Internal Revenue Code).

(B) Purchased and placed in service by the qualified taxpayer for exclusive use in a trade or business conducted within a targeted tax area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(C) Purchased and placed in service before the date the targeted tax area designation expires, is revoked, is no longer binding, or becomes inoperative.

(2) For purposes of paragraph (1), ''purchase'' means any acquisition of property, but only if all of the following apply:

(A) The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under Section 267 or 707(b) of the Internal Revenue Code. However, in applying Sections 267(b) and 267(c) for purposes of this section, Section 267(c)(4) shall be treated as providing that the family of an individual shall include only the individual's spouse, ancestors, and lineal descendants.

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

(C) The basis of the property in the hands of the person acquiring it is not determined in whole or in part

by reference to the adjusted basis of that property in the hands of the person from who it is acquired.

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

(4) This section shall not apply to any property for which the qualified taxpayer may not make an election under Section 179 of the Internal Revenue Code because of the application of the provisions of Section 179(d) of the Internal Revenue Code.

(5) For purposes of subdivision (b), both of the following apply:

(A) All members of an affiliated group shall be treated as one qualified taxpayer.

(B) The qualified taxpayer shall apportion the dollar limitation contained in subdivision (f) among the members of the affiliated group in whatever manner the board shall prescribe.

(6) For purposes of paragraphs (2) and (5), ‘‘affiliated group’’ means ‘‘affiliated group’’ as defined in Section 1504 of the Internal Revenue Code, except that, for these purposes, the phrase ‘‘more than 50 percent’’ shall be substituted for the phrase ‘‘at least 80 percent’’ each place it appears in Section 1504(a) of the Internal Revenue Code.

(d) (1) For purposes of this section, ‘‘qualified taxpayer’’ means a corporation that meets both of the following:

(A) Is engaged in conducting a trade or business within a targeted tax area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(B) Is engaged in those lines of business described in Codes 2000 to 2099, inclusive; 2200 to 3999, inclusive; 4200 to 4299, inclusive; 4500 to 4599, inclusive, and 4700 to 5199, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(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 deduction under this section or Section 17267.6 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 10 (commencing with Section 17001). For purposes of this subparagraph, the term ‘‘pass-through entity’’ means any partnership or S corporation.

(e) Any qualified taxpayer who elects to be subject to this section shall not be entitled to claim additional depreciation pursuant to Section 24356 with respect to any property that constitutes Section 24356.6 property. However, the qualified taxpayer may claim depreciation by any method permitted by Section 24349 commencing with the ~~income~~ *taxable* year following the ~~income~~ *taxable* year in which Section 24356.6 property is placed in service.

(f) The aggregate cost of all Section 24356.6 property that may be taken into account under subdivision (a) for any ~~income~~ *taxable* year shall not exceed the following applicable amount for the ~~income~~ *taxable* year of the designation of the relevant targeted tax area and ~~income~~ *taxable* years thereafter:

	The applicable amount is:
~~Income~~ *Taxable* year of designation	$100,000
1st ~~income~~ *taxable* year thereafter	100,000
2nd ~~income~~ *taxable* year thereafter	75,000
3rd ~~income~~ *taxable* year thereafter	75,000
Each ~~income~~ *taxable* year thereafter	50,000

(g) Any amounts deducted under subdivision (a) with respect to Section 24356.6 property that ceases to be used in the qualified taxpayer’s trade or business within a targeted tax area at any time before the close of the second ~~income~~ *taxable* year after the property is placed

in service shall be included in income in the ~~income~~ *taxable* year in which the property ceases to be so used.

SEC. 140. Section 24356.7 of the Revenue and Taxation Code is amended to read:

24356.7. (a) A taxpayer may elect to treat 40 percent of the cost of any Section 24356.7 property as an expense that is not chargeable to a capital account. Any cost so treated shall be allowed as a deduction for the ~~income~~ *taxable* year in which the taxpayer places the Section 24356.7 property in service.

(b) (1) An election under this section for any ~~income~~ *taxable* year shall do both of the following:

(A) Specify the items of Section 24356.7 property to which the election applies and the percentage of the cost of each of those items that are to be taken into account under subdivision (a).

(B) Be made on the taxpayer's original return of the tax imposed by this part for the ~~income~~ *taxable* year.

(2) Any election made under this section, and any specification contained in that election, may not be revoked except with the consent of the Franchise Tax Board.

(c) (1) For purposes of this section, ''Section 24356.7 property'' means any recovery property that is:

(A) Section 1245 property (as defined in Section 1245(a)(3) of the Internal Revenue Code).

(B) Purchased and placed in service by the taxpayer for exclusive use in a trade or business conducted within an enterprise zone designated pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(C) Purchased and placed in service before the date the enterprise zone designation expires, is no longer binding, or becomes inoperative.

(2) For purposes of paragraph (1), ''purchase'' means any acquisition of property, but only if all of the following apply:

(A) The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under Sections 24427 through

24429. However, in applying Sections 24428 and 24429 for purposes of this section, subdivision (d) of Section 24429 shall be treated as providing that the family of an individual shall include only his or her spouse, ancestors, and lineal descendants.

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

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

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

(4) This section shall not apply to any property for which the taxpayer could not make a federal election under Section 179 of the Internal Revenue Code because of the application of the provisions of Section 179(d) of the Internal Revenue Code.

(5) For purposes of subdivision (b) of this section, both of the following apply:

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

(B) The taxpayer shall apportion the dollar limitation contained in subdivision (f) among the members of the affiliated group in whatever manner the board shall prescribe.

(6) For purposes of paragraphs (2) and (5), ‘‘affiliated group’’ means ‘‘affiliated group’’ as defined in Section 1504 of the Internal Revenue Code, except that, for these purposes, the phrase ‘‘more than 50 percent’’ shall be substituted for the phrase ‘‘at least 80 percent’’ each place it appears in Section 1504(a) of the Internal Revenue Code.

(d) For purposes of this section, ‘‘taxpayer’’ means a bank or corporation that conducts a trade or business within an enterprise zone designated pursuant to

Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(e) Any taxpayer who elects to be subject to this section shall not be entitled to claim additional depreciation pursuant to Section 24356 with respect to any property that constitutes Section 24356.7 property. However, the taxpayer may claim depreciation by any method permitted by Section 24349 commencing with the ~~income~~ *taxable* year following the ~~income~~ *taxable* year in which Section 24356.7 property is placed in service.

(f) The aggregate cost of all Section 24356.7 property that may be taken into account under subdivision (a) for any ~~income~~ *taxable* years shall not exceed the following applicable amount for the ~~income~~ *taxable* year of the designation of the relevant enterprise zone and ~~income~~ *taxable* years thereafter:

	The applicable amount is:
~~Income~~ *Taxable* year of designation	$100,000
1st ~~income~~ *taxable* year thereafter	100,000
2nd ~~income~~ *taxable* year thereafter	75,000
3rd ~~income~~ *taxable* year thereafter	75,000
Each ~~income~~ *taxable* year thereafter	50,000

(g) Any amounts deducted under subdivision (a) with respect to Section 24356.7 property that ceases to be used in the taxpayer's trade or business within an enterprise zone at any time before the close of the second ~~income~~ *taxable* year after the property is placed in service shall be included in income in the ~~income~~ *taxable* year in which the property ceases to be so used.

SEC. 141. Section 24356.8 of the Revenue and Taxation Code is amended to read:

24356.8. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1995, a taxpayer may elect to treat 40 percent of the cost of any Section 24356.8 property as an expense that is not chargeable to the capital account. Any cost so treated shall be allowed as a deduction for the

~~income~~ *taxable* year in which the taxpayer places the Section 24356.8 property in service.

(b) (1) An election under this section for any ~~income~~ *taxable* year shall meet both of the following requirements:

(A) Specify the items of Section 24356.8 property to which the election applies and the portion of the cost of each of those items that is to be taken into account under subdivision (a).

(B) Be made on the taxpayer's return of the tax imposed by this part for the ~~income~~ *taxable* year.

(2) Any election made under this section, and any specification contained in that election, may not be revoked except with the consent of the Franchise Tax Board.

(c) (1) For purposes of this section, ''Section 24356.8 property'' means any recovery property that is:

(A) Section 1245 property (as defined in Section 1245(a)(3) of the Internal Revenue Code).

(B) Purchased by the taxpayer for exclusive use in a trade or business conducted within a LAMBRA.

(C) Purchased before the date the LAMBRA designation expires, is no longer binding, or becomes inoperative.

(2) For purposes of paragraph (1), ''purchase'' means any acquisition of property, but only if all of the following apply:

(A) The property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under Section 267 or 707(b) of the Internal Revenue Code (but, in applying Sections 267(b) and 267(c) of the Internal Revenue Code for purposes of this section, Section 267(c)(4) of the Internal Revenue Code shall be treated as providing that the family of an individual shall include only his or her spouse, ancestors, and lineal descendants).

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

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

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

(4) This section shall not apply to any property for which the taxpayer may not make an election for the ~~income~~ *taxable* year under Section 179 of the Internal Revenue Code because of the provisions of Section 179(d) of the Internal Revenue Code.

(5) For purposes of subdivision (b), both of the following apply:

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

(B) The taxpayer shall apportion the dollar limitation contained in subdivision (f) among the component members of the affiliated group in whatever manner the board shall by regulations prescribe.

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

(7) This section shall not apply to any property described in Section 168(f) of the Internal Revenue Code.

(8) In the case of an S corporation, the dollar limitation contained in subdivision (f) shall be applied at the entity level and at the shareholder level.

(d) For purposes of this section:

(1) ‘‘LAMBRA’’ means a local agency military base recovery area designated in accordance with the provisions of Section 7114 of the Government Code.

(2) ‘‘Taxpayer’’ means a corporation that conducts a trade or business within a LAMBRA and, for the first two

~~income~~ *taxable* years, has a net increase in jobs (defined as 2,000 paid hours per employee per year) of one or more employees in the LAMBRA.

(A) The net increase in the number of jobs shall be determined by subtracting the total number of full-time employees (defined as 2,000 paid hours per employee per year) the taxpayer employed in this state in the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA from the total number of full-time employees the taxpayer employed in this state during the second ~~income~~ *taxable* year after commencing business operations in the LAMBRA. For taxpayers who commence doing business in this state with their LAMBRA business operation, the number of employees for the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA shall be zero. If the taxpayer has a net increase in jobs in the state, the credit shall be allowed only if one or more full-time employees is employed within the LAMBRA.

(B) The total number of employees employed in the LAMBRA shall equal the sum of both of the following:

(i) The total number of hours worked in the LAMBRA for the taxpayer by employees (not to exceed 2,000 hours per employee) who are paid an hourly wage divided by 2,000.

(ii) The total number of months worked in the LAMBRA for the taxpayer by employees who are salaried employees divided by 12.

(C) In the case of a taxpayer that first commences doing business in the LAMBRA during the ~~income~~ *taxable* year, for purposes of clauses (i) and (ii), respectively, of subparagraph (B), the divisors ‘‘2,000’’ and ‘‘12’’ shall be multiplied by a fraction, the numerator of which is the number of months of the ~~income~~ *taxable* year that the taxpayer was doing business in the LAMBRA and the denominator of which is 12.

(e) Any taxpayer who elects to be subject to this section shall not be entitled to claim additional depreciation pursuant to Section 24356 with respect to any property that constitutes Section 24356.8 property.

(f) The aggregate cost of all Section 24356.8 property that may be taken into account under subdivision (a) for any ~~income~~ *taxable* year shall not exceed the following applicable amounts for the ~~income~~ *taxable* year of the designation of the relevant LAMBRA and ~~income~~ *taxable* years thereafter:

	The applicable amount is:
~~Income~~ *Taxable* year of designation	$100,000
1st ~~income~~ *taxable* year thereafter	100,000
2nd ~~income~~ *taxable* year thereafter	75,000
3rd ~~income~~ *taxable* year thereafter	75,000
Each ~~income~~ *taxable* year thereafter	50,000

(g) This section shall apply only to property that is used exclusively in a trade or business conducted within a LAMBRA.

(h) (1) Any amounts deducted under subdivision (a) with respect to property that ceases to be used in the trade or business within a LAMBRA at any time before the close of the second ~~income~~ *taxable* year after the property was placed in service shall be included in income for that year.

(2) At the close of the second ~~income~~ *taxable* year, if the taxpayer has not increased the number of its employees as determined by paragraph (2) of subdivision (d), then the amount of the deduction previously claimed shall be added to the taxpayer's net income for the taxpayer's second ~~income~~ *taxable* year.

(i) Any taxpayer who elects to be subject to this section shall not be entitled to claim for the same property the deduction under Section 179 of the Internal Revenue Code, relating to an election to expense certain depreciable business assets.

SEC. 142. Section 24357 of the Revenue and Taxation Code is amended to read:

24357. (a) There shall be allowed as a deduction any charitable contribution (as defined in Section 24359)

payment of which is made within the ~~income~~ *taxable* year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Franchise Tax Board.

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

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

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

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

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

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

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

(2) No deduction shall be denied under Section 170(f)(8) of the Internal Revenue Code, relating to substantiation requirement for certain contributions,

upon a showing that the requirements in Section 170(f)(8) of the Internal Revenue Code have been met with respect to that contribution for federal purposes.

SEC. 143. Section 24357.2 of the Revenue and Taxation Code is amended to read:

24357.2. (a) In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer's entire interest in such property, a deduction shall be allowed under Section 24357 only to the extent that the value of the interest contributed would be allowable as a deduction under Section 24357 if such interest had been transferred in trust. For purposes of this subdivision, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer's entire interest in such property.

(b) Subdivision (a) shall not apply to a contribution of—

(1) A remainder interest in a personal residence or farm,

(2) An undivided portion of the taxpayer's entire interest in property,

(3) A qualified conservation contribution (as defined in Section 24357.7).

(c) The amendments made to this section by the 1977–78 Legislature shall apply with respect to contributions of transfers made after December 31, 1976, and before June 14, 1977.

(d) The amendments made to this section by the 1981–82 Regular Session of the Legislature shall apply with respect to contributions or transfers made in ~~income~~ *taxable* years beginning on and after January 1, 1982.

SEC. 144. 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~~ *taxable* 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. 145. Section 24357.9 of the Revenue and Taxation Code is amended 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~~ *taxable* year beginning on or after January 1, 2000.

SEC. 146. Section 24358 of the Revenue and Taxation Code is amended to read:

24358. (a) In the case of a corporation, the total deductions under Section 24357 for any ~~income~~ *taxable* year shall not exceed 10 percent of the taxpayer's net income computed without regard to any of the following:

(1) Subdivision (e) of Section 23802, relating to a deduction for built-in gains and passive investment income.

(2) Sections 24357 to 24359, inclusive, relating to the deduction for contributions.

(3) Article 2 (commencing with Section 24401) of Chapter 7 (except Sections 24407 to 24409, inclusive, relating to organizational expenses).

(b) Section 170(d)(2) of the Internal Revenue Code, relating to carryovers of excess contributions, shall apply with respect to excess contributions made during ~~income~~ *taxable* years beginning on or after January 1, 1996.

SEC. 147. Section 24360 of the Revenue and Taxation Code is amended to read:

24360. In the case of any bond, as defined in Section 24363, the following rules shall apply to the amortizable bond premium (determined under Section 24361 on the bond):

(a) In the case of a bond, the amount of the amortizable bond premium for the ~~income~~ *taxable* year shall be allowed as a deduction.

(b) In the case of any bond the interest on which is excludable from gross income under Chapter 3 (commencing with Section 23501), no deduction shall be allowed for the amortizable bond premium for the taxable year.

SEC. 148. Section 24361 of the Revenue and Taxation Code is amended to read:

24361. (a) For purposes of subsection (b), the amount of bond premium, in the case of the holder of any bond, shall be determined—

(1) With reference to the amount of the basis (for determining loss on sale or exchange) of such bond;

(2) With reference to the amount payable on maturity or on earlier call date; and

(3) With adjustments proper to reflect unamortized bond premium, with respect to the bond, for the period before the date as of which Section 24360 becomes applicable with respect to the taxpayer with respect to such bond.

In no case shall the amount of bond premium on a convertible bond include any amount attributable to the conversion features of the bond.

(b) The amortizable bond premium of the ~~income~~ *taxable* year shall be the amount of the bond premium attributable to such year. In the case of a bond described in Section 24362(a) issued after January 22, 1951, and acquired after January 22, 1954, which has a call date not more than three years after the date of such issue, the amount of bond premium attributable to the ~~income~~ *taxable* year in which the bond is called shall include an amount equal to the excess of the amount of the adjusted basis (for determining loss on sale or exchange) of such bond as of the beginning of the ~~income~~ *taxable* year over the amount received on redemption of the bond or (if greater) the amount payable on maturity.

(c) (1) Except as provided in regulations, the determinations required under subdivisions (a) and (b) shall be made on the basis of the taxpayer's yield to maturity determined by—

(A) Using the taxpayer's basis for purposes of determining loss on sale or exchange of the obligation, and

(B) Compounding at the close of each accrual period (as defined in Section 1272(a)(5) of the Internal Revenue Code).

(2) For purposes of paragraph (1), if the amount payable on an earlier call date is used under subparagraph (B) of paragraph (1) in determining the amortizable bond premium attributable to the period before the earlier call date, that bond shall be treated as maturing on that date for the amount so payable and then reissued on that date for the amount so payable.

SEC. 149. Section 24362 of the Revenue and Taxation Code is amended to read:

24362. (a) Sections 24360 to 24363.5, inclusive, shall apply to the bonds only if the taxpayer has elected to have these sections apply; in the case of any taxpayer, bonds the interest on which is not excludable from gross income.

(b) The election authorized under this section shall be made in accordance with such regulations as the Franchise Tax Board shall prescribe. If such election is made with respect to any bond (described in subsection (a)) of the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first ~~income~~ *taxable* year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent ~~income~~ *taxable* years with respect to all such bonds of the taxpayer, unless, on application by the taxpayer, the Franchise Tax Board permits him, subject to such conditions as the Franchise Tax Board deems necessary, to revoke such election.

SEC. 150. Section 24363 of the Revenue and Taxation Code is amended to read:

24363. For purposes of Sections 24360 to 24363.5, inclusive, the term ''bond'' means any bond, debenture, note, or certificate or other evidence of indebtedness, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the ~~income~~ *taxable* year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

SEC. 151. Section 24364 of the Revenue and Taxation Code is amended to read:

24364. Notwithstanding Article 3 (commencing with Section 24421), all expenditures (other than expenditures for the purchase of land or depreciable property or for the acquisition of circulation through the purchase of any part of the business of another publisher of a newspaper, magazine, or other periodical) to establish, maintain, or increase the circulation of a newspaper, magazine, or

other periodical shall be allowed as a deduction. However, the deduction shall not be allowed with respect to the portion of such expenditures as, under regulations prescribed by the Franchise Tax Board, is chargeable to capital account if the taxpayer elects, in accordance with those regulations, to treat that portion as so chargeable. The election, if made, shall be for the total amount of that portion of the expenditures which is so chargeable to capital account, and shall be binding for all subsequent ~~income~~ *taxable* years unless, upon application by the taxpayer, the Franchise Tax Board permits a revocation of the election subject to such conditions as it deems necessary.

SEC. 152. Section 24377 of the Revenue and Taxation Code is amended to read:

24377. (a) A taxpayer engaged in the business of farming may elect to treat as expenses which are not chargeable to capital account expenditures (otherwise chargeable to capital account) which are paid or incurred by it during the ~~income~~ *taxable* year for the purchase or acquisition of fertilizer, lime, ground limestone, marl, or other materials to enrich, neutralize, or condition land used in farming, or for the application of such materials to such land. The expenditures so treated shall be allowed as a deduction.

(b) For purposes of subdivision (a), the term ‘‘land used in farming’’ means land used (before or simultaneously with the expenditures described in subdivision (a)) by the taxpayer or its tenant for the production of crops, fruits, or other agricultural products or for the sustenance of livestock.

(c) The election under subdivision (a) for any ~~income~~ *taxable* year shall be made within the time prescribed by law (including extensions thereof) for filing the return for that ~~income~~ *taxable* year. The election shall be made in the form and manner as the Franchise Tax Board may prescribe. The election may not be revoked except with the consent of the Franchise Tax Board.

SEC. 153. Section 24383 of the Revenue and Taxation Code is amended to read:

24383. (a) Every taxpayer, at the election of the taxpayer, shall be entitled to a deduction of the cost of repairing or remodeling any building, facility or transportation vehicle owned or leased by the taxpayer at the time of such repairing or remodeling, in order to permit handicapped or elderly individuals to enter or leave such building, facility or transportation vehicle, to increase the access handicapped or elderly individuals would have to such building, facility or transportation vehicle, or to allow handicapped or elderly individuals more effective use of the building, facility or transportation vehicle, provided that the repair or remodeling meets one or more standards established pursuant to Section 4450 or 4451 of the Government Code. In the absence of such state standards, those standards established by the Secretary of the Treasury of the United States with the concurrence of the Architectural and Transportation Barriers Compliance Board shall be used. The installation of emergency egress/safe area refuge systems shall be eligible for such deductions.

(b) The deduction authorized by this section shall be taken with respect to the ~~income~~ *taxable* year in which such repairing or remodeling is completed.

(c) The deduction provided by this section with respect to any ~~income~~ *taxable* year shall be in lieu of any deduction with respect to such repairing or remodeling relating to exhaustion, wear and tear or obsolescence. If, however, the costs of that repair or remodeling exceed the limit set forth in subdivision (g), the remaining balance may be charged to capital account.

(d) If any building, facility or transportation vehicle is owned by more than one person, a taxpayer may deduct a portion of the costs of such repairing or remodeling apportionate to the interest in such building, facility or transportation vehicle which is owned by the taxpayer.

(e) For purposes of this section, ‘‘building, facility or transportation vehicle’’ means a building, facility or transportation vehicle, or part thereof, which is intended

to be used, and is actually used, by the taxpayer or the general public, in the taxpayer's business or trade.

(f) For purposes of this section, ''handicapped individual'' means any individual who has a physical or mental disability (including, but not limited to, blindness or deafness) which for such individual constitutes or results in a functional limitation to employment, or who has any physical or mental impairment (including, but not limited to, a sight or hearing impairment) which substantially limits one or more major life activities of such individual, and ''elderly individual'' means an individual who is 65 years of age or older.

(g) The deduction authorized by this section shall not exceed fifteen thousand dollars ($15,000) with respect to any taxpayer for any ~~income~~ *taxable* year.

(h) The Franchise Tax Board shall prescribe such regulations as may be necessary to carry out the provisions of this section.

(i) This section shall apply to ~~income~~ *taxable* years beginning after December 31, 1976.

(j) (1) The State Fire Marshal in cooperation with the Department of Rehabilitation and the Department of Aging shall adopt building standards and regulations for emergency egress/safe area refuge systems. The building standards and regulations shall include, but not be limited to, minimum requirements for safety, reliability, durability and usability. Emergency egress/safe area refuge systems that comply with the building standards and regulations adopted pursuant to this section shall be eligible for the deduction provided by this section.

(2) It is the intent of the Legislature that this section and the building standards adopted pursuant to this section do not supersede more restrictive building standards and regulations adopted by the state and local governments.

(k) ''Emergency egress/safe area refuge system'' shall include, but not be limited to, all of the following:

(1) A building floor divided into not less than two compartments by not less than one-hour fire-resistive construction. Each door opening in the construction shall

be protected by a twenty minute fire-resistive assembly as defined in regulations of the State Fire Marshal. Duct openings shall be protected by single-blade or curtain-type fire dampers to restrict the passage of smoke or flame. The smaller of the compartmental areas shall be not less than one-fourth the floor area of the story. Each such compartment shall contain a stairway or elevator or other means of ready egress from the building.

(2) A fire alarm system defined in regulations by the State Fire Marshal.

(3) Use of existing exiting systems and warning devices when practical, including, but not limited to, stairways, elevators, and fire alarms.

(4) Accommodations for wheelchairs and all attached wheelchair equipment, as well as wheelchair occupants.

(5) Its own power source.

SEC. 154. Section 24402 of the Revenue and Taxation Code is amended to read:

24402. (a) A portion of the dividends received during the ~~income~~ *taxable* 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. 155. Section 24404 of the Revenue and Taxation Code is amended to read:

24404. In the case of farmers, fruit growers, or like associations organized and operated in whole or in part on a cooperative or mutual basis, (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, which may include reasonable reserves, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing, or producing, supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses, all income resulting from or arising out of such business activities for or with their members carried on by them or their agents; or when done on a nonprofit basis for or with nonmembers.

For the purposes of this section ‘‘all income resulting from or arising out of such business activities for or with their members’’ shall include all amounts, whether or not derived from patronage, allocated to members during the ~~income~~ *taxable* year. Amounts allocated include cash, merchandise, capital stock, revolving fund certificates, certificates of indebtedness, retain certificates, letters of advice, or written instruments which in some other manner disclose to each member the dollar amount allocated to him. Allocations made after the close of the ~~income~~ *taxable* year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such ~~income~~ *taxable* year to the extent the allocations are attributable to income derived before the close of such year.

SEC. 156. Section 24409 of the Revenue and Taxation Code is amended to read:

24409. The election provided by Section 24407 may be made for any ~~income~~ *taxable* year beginning after December 31, 1960, but only if made not later than the time prescribed by law for filing the return for that ~~income~~ *taxable* year (including extensions thereof). The period so elected shall be adhered to in computing the income of the corporation for the ~~income~~ *taxable* year for which the election is made and all subsequent ~~income~~ *taxable* years. The election shall apply only with respect to the expenditures paid or incurred on or after June 23, 1961.

SEC. 157. Section 24410 of the Revenue and Taxation Code is amended to read:

24410. (a) Dividends received by a corporation commercially domiciled in California during the ~~income~~ *taxable* year from an insurance company subject to tax imposed by Part 7 (commencing with Section 12001) of this division at the time of the payment of the dividends and at least 80 percent of each class of its stock then being owned by the corporation receiving the dividend.

(b) The deduction under this section shall be limited to that portion of the dividends received which are

determined to be paid from income from California sources determined pursuant to subdivision (c).

(c) Dividends paid from California sources shall be determined by multiplying the amount of the dividends by an apportionment factor equal to the ratio of gross income from California sources to all gross income of the company. Gross income from California sources equals total gross income less dividends from other insurance companies multiplied by the average of the following three factors:

(1) A gross receipts factor, the denominator of which shall include all receipts, other than dividends from another insurance company, regardless of the nature or source from which derived. The numerator of which shall include all gross receipts, other than dividends from another insurance company, derived from or attributable to this state. With respect to premiums, only receipts which were subject to tax under Part 7 (commencing with Section 12001) of this division, shall be included in the numerator, and with respect to income from intangibles they shall be attributable to the commercial domicile of the insurance company.

(2) A payroll factor determined under the provisions of the Uniform Division of Income for Tax Purposes Act, Chapter 17, Article 2 of this part.

(3) A property factor, determined under the provisions of the Uniform Division of Income for Tax Purposes Act provided for in Article 2 (commencing with Section 25120) of Chapter 17 of this part, provided that for the purposes of this paragraph the property factor shall include all intangible investment property, which intangible property shall be allocated to the commercial domicile of that insurance company.

(4) Plus the portion of the dividends received from another insurance company determined to be paid from California source income pursuant to the formula set forth in paragraphs (1) through (3) based upon the receipts, payroll and property of that other insurance company.

(d) The insurance company from which the dividends are received shall furnish that information as the Franchise Tax Board may require to determine the allocation formula and the Franchise Tax Board may adopt those regulations as it deems necessary to effectuate the purpose of this section.

Nothing in this section shall be construed to limit or affect in any manner any other provisions of this part.

SEC. 158. Section 24415 of the Revenue and Taxation Code is amended to read:

24415. (a) To the extent specified in subdivision (b), there shall be allowed as a deduction to a taxpayer those payments of the taxpayer which are made pursuant to an interindemnity arrangement specified in Section 1280.7 of the Insurance Code and which are paid to a trust of members of a cooperative corporation organized and operated under Part 2 (commencing with Section 12200) of Division 3 of Title 1 of the Corporations Code and the members of which consist solely of physicians and surgeons licensed in this state.

(b) The deduction authorized by subdivision (a) shall be taken with respect to the ~~income~~ *taxable* year in which the payment is made and shall be taken only to the extent that the payment does not exceed the amount which would otherwise be payable to an independent insurance company for similar coverage for medical malpractice insurance in that ~~income~~ *taxable* year. Any portion of the payment in excess of that amount shall be treated as a payment under the interindemnity arrangement for five succeeding ~~income~~ *taxable* years and may be carried forward as a deduction to those five succeeding ~~income~~ *taxable* years until used. The deduction shall be applied first to the earliest years possible.

(c) In the event any payment is refunded by the trust to the taxpayer for any reason, the payment shall be included in the taxpayer's income for the ~~income~~ *taxable* year in which it is received to the extent that the payment or any portion thereof was taken as a deduction in any earlier ~~income~~ *taxable* year.

(d) Any refund of a payment which is made by a trust to a taxpayer shall be reported by the trust to the Franchise Tax Board in the year in which the refund is made. The trust shall furnish the taxpayer with a copy of that report. In the case of any payment to be made to a taxpayer who is not a resident of the State of California in the year in which the refund is made, the Franchise Tax Board may, by regulation, require the trust to withhold an amount from the refund, determined by the Franchise Tax Board to reasonably represent the amount of tax due when that refund is included with other income of the taxpayer, and to transmit the amount withheld to the Franchise Tax Board at a time as it may designate.

(e) For purposes of this section:

(1) ''Payment'' means a contribution to or an assessment by an interindemnity arrangement described in Section 1280.7 of the Insurance Code.

(2) ''Taxpayer'' means a corporation whose shares are held by a physician and surgeon, or physicians and surgeons, licensed in this state which is a participating member in an interindemnity arrangement described in Section 1280.7 of the Insurance Code.

(3) ''Trust'' means a trust described in subdivision (a).

(f) Upon request, the trust shall submit to the Franchise Tax Board the names and membership dates of all participating corporations.

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

SEC. 159. Section 24416 of the Revenue and Taxation Code is amended to read:

24416. Except as provided in Section 24416.1, 24416.2, 24416.4, 24416.5, or 24416.6, 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~~ *taxable* years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any ~~income~~ *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 ~~income~~ *taxable* year shall not be eligible for carryover to any subsequent ~~income~~ *taxable* year.

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

business during that ~~income~~ *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 ~~income~~ *taxable* 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~~ *taxable* years following the ~~income~~ *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 ~~income~~ *taxable* years following the ~~income~~ *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 ~~an income~~ *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 ~~income~~ *taxable* years of the new business.

(5) In the case of a taxpayer who has a net operating loss in ~~an income~~ *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 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~~ *taxable* 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~~ *taxable* 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~~ *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 ~~income~~ *taxable* years’’ in lieu of ‘‘20 taxable years.’’

(2) In the case of a ‘‘new business,’’ the ‘‘five ~~income~~ *taxable* years’’ referred to in paragraph (1) shall be modified to read as follows:

(A) ‘‘Eight ~~income~~ *taxable* years’’ for a net operating loss attributable to the first ~~income~~ *taxable* year of that new business.

(B) ‘‘Seven ~~income~~ *taxable* years’’ for a net operating loss attributable to the second ~~income~~ *taxable* year of that new business.

(C) ‘‘Six ~~income~~ *taxable* years’’ for a net operating loss attributable to the third ~~income~~ *taxable* 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~~ *taxable* years beginning in 1991.

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

(4) The net operating loss attributable to ~~income~~ *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 ~~income~~ *taxable* 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~~ *a taxable* year after the ~~income~~ *taxable* 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~~ *taxable* 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~~ *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 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~~ *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.

(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~~ *taxable* year which may be carried forward to another ~~income~~ *taxable* year.

(2) The amount of any loss carry forward which may be deducted in any ~~income~~ *taxable* 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~~ *taxable* years beginning on or after January 1, 1997.

SEC. 160. Section 24416.2 of the Revenue and Taxation Code is amended to read:

24416.2. (a) The term ‘‘qualified taxpayer’’ as used in Section 24416.1 includes a corporation engaged in the conduct of a trade or business within an enterprise zone designated pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code. For purposes of this subdivision, all of the following shall apply:

(1) A net operating loss shall not be a net operating loss carryback for any ~~income~~ *taxable* year and a net operating loss for any ~~income~~ *taxable* year beginning on or after the date that the area in which the taxpayer conducts a trade or business is designated as an enterprise zone shall be a net operating loss carryover to each of the 15 ~~income~~ *taxable* years following the ~~income~~ *taxable* year of loss.

(2) For purposes of this subdivision:

(A) ‘‘Net operating loss’’ means the loss determined under Section 172 of the Internal Revenue Code, as modified by Section 24416.1, attributable to the taxpayer’s business activities within the enterprise zone (as defined in Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code) prior to the enterprise zone expiration date. That attributable loss shall be determined in accordance with Chapter 17 (commencing with Section 25101), modified for purposes of this subdivision as follows:

(i) Loss shall be apportioned to the enterprise zone by multiplying total loss from the business by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two.

(ii) ‘‘The enterprise zone’’ shall be substituted for ‘‘this state.’’

(B) A net operating loss carryover shall be a deduction only with respect to the taxpayer’s business income attributable to the enterprise zone as defined in Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(C) Attributable income is that portion of the taxpayer’s California source business income that is apportioned to the enterprise zone. For that purpose, the

taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the enterprise zone in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this subdivision as follows:

(i) Business income shall be apportioned to the enterprise zone by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this clause:

(I) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the enterprise zone during the ~~income~~ *taxable* year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year.

(II) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the enterprise zone during the ~~income~~ *taxable* year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ *taxable* year.

(ii) If a loss carryover is allowable pursuant to this section for any ~~income~~ *taxable* year after the enterprise zone designation has expired, the enterprise zone shall be deemed to remain in existence for purposes of computing the limitation set forth in subparagraph (B) and allowing a net operating loss deduction.

(D) ''Enterprise zone expiration date'' means the date the enterprise zone designation expires, is no longer binding, or becomes inoperative.

(3) The changes made to this subdivision by the act adding this paragraph shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1998.

(b) A taxpayer who qualifies as a ''qualified taxpayer'' under one or more sections shall, for the ~~income~~ *taxable* year of the net operating loss and any ~~income~~ *taxable* year to which that net operating loss may be carried, designate on the original return filed for each year the section which applies to that taxpayer with respect to that net operating loss. If the taxpayer is eligible to qualify under more than one section, the designation is to be made after taking into account subdivision (c).

(c) If a taxpayer is eligible to qualify under this section and either Section 24416.4, 24416.5, or 24416.6 as a ''qualified taxpayer,'' with respect to a net operating loss in ~~an income~~ *a taxable* year, the taxpayer shall designate which section is to apply to the taxpayer.

(d) Notwithstanding Section 24416, the amount of the loss determined under this section, or Section 24416.4, 24416.5, or 24416.6 shall be the only net operating loss allowed to be carried over from that ~~income~~ *taxable* year and the designation under subdivision (b) shall be included in the election under Section 24416.1.

SEC. 161. Section 24416.4 of the Revenue and Taxation Code is amended to read:

24416.4. (a) The term ''qualified taxpayer'' as used in Section 24416.1 includes a corporation engaged in the conduct of a trade or business within the Los Angeles Revitalization Zone designated pursuant to Section 7102 of the Government Code. For purposes of this subdivision, all of the following shall apply:

(1) A net operating loss shall not be a net operating loss carryback for any ~~income~~ *taxable* year and, except as provided in subparagraph (B), a net operating loss for any ~~income~~ *taxable* year beginning on or after the date the area in which the taxpayer conducts a trade or business is designated the Los Angeles Revitalization Zone shall be a net operating loss carryover to each following ~~income~~ *taxable* year that ends before the Los Angeles Revitalization Zone expiration date or to each of the 15 ~~income~~ *taxable* years following the ~~income~~ *taxable* year of loss, if longer.

(2) In the case of a financial institution to which Section 585, 586, or 593 of the Internal Revenue Code applies, a net operating loss for any ~~income~~ *taxable* year beginning on or after January 1, 1984, shall be a net operating loss carryover to each of the five years following the ~~income~~ *taxable* year of the loss. Subdivision (b) of Section 24416.1 shall not apply.

(3) ''Net operating loss'' means the loss determined under Section 172 of the Internal Revenue Code, as modified by Section 24416.1, attributable to the taxpayer's business activities within the Los Angeles Revitalization Zone (as defined in Section 7102 of the Government Code) prior to the Los Angeles Revitalization Zone expiration date. The attributable loss shall be determined in accordance with Chapter 17 (commencing with Section 25101) of Part 11, modified as follows:

(A) The loss shall be apportioned to the Los Angeles Revitalization Zone by multiplying the loss from the business by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is 2.

(B) ''The Los Angeles Revitalization Zone'' shall be substituted for ''this state.''

(4) A net operating loss carryover shall be a deduction only with respect to the taxpayer's business income attributable to the Los Angeles Revitalization Zone (as defined in Section 7102 of the Government Code) determined in accordance with subdivision (c).

(5) If a loss carryover is allowable pursuant to this section for any ~~income~~ *taxable* year after the Los Angeles Revitalization Zone designation has expired, the Los Angeles Revitalization Zone shall be deemed to remain in existence for purposes of computing the limitation set forth in paragraph (2) and allowing a net operating loss deduction.

(6) Attributable income shall be that portion of the taxpayer's California source business income which is apportioned to the Los Angeles Revitalization Zone. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in

accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the Los Angeles Revitalization Zone in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified as follows:

(A) Business income shall be apportioned to the Los Angeles Revitalization Zone by multiplying total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is 2.

(B) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the Los Angeles Revitalization Zone during the ~~income~~ *taxable* year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year.

(C) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the Los Angeles Revitalization Zone during the ~~income~~ *taxable* year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ *taxable* year.

(7) ''Los Angeles Revitalization Zone expiration date'' means the date the Los Angeles Revitalization Zone designation expires, is repealed, or becomes inoperative pursuant to Section 7102, 7103, or 7104 of the Government Code.

(b) This section shall be inoperative on the first day of the ~~income~~ *taxable* year beginning on or after the determination date, and each ~~income~~ *taxable* year thereafter, with respect to the taxpayer's business activities within a geographic area that is excluded from the map pursuant to Section 7102 of the Government Code, or an excluded area determined pursuant to Section 7104 of the Government Code. The determination date is the earlier of the first effective date of a determination under subdivision (c) of Section 7102 of the Government Code occurring after December 1,

1994, or the first effective date of an exclusion of an area from the amended Los Angeles Revitalization Zone under Section 7104 of the Government Code. However, if the taxpayer has any unused loss amount as of the date this section becomes inoperative, that unused loss amount may continue to be carried forward as provided in this section.

(c) A taxpayer who qualifies as a ''qualified taxpayer'' under one or more sections shall, for the ~~income~~ *taxable* year of the net operating loss and any ~~income~~ *taxable* year to which that net operating loss may be carried, designate on the original return filed for each year the section that applies to that taxpayer with respect to that net operating loss. If the taxpayer is eligible to qualify under more than one section, the designation is to be made after taking into account subdivision (d).

(d) If a taxpayer is eligible to qualify under this section and either Section 24416.2, 24416.5, or 24416.6 as a ''qualified taxpayer,'' with respect to a net operating loss in ~~an income~~ *a taxable* year, the taxpayer shall designate which section is to apply to the taxpayer.

(e) Notwithstanding Section 24416, the amount of the loss determined under this section or Section 24416.2, 24416.5, or 24416.6 shall be the only net operating loss allowed to be carried over from that ~~income~~ *taxable* year and the designation under subdivision (c) shall be included in the election under Section 24416.1.

(f) This section shall cease to be operative on December 1, 1998. However, any unused net operating loss may continue to be carried over to following years as provided in this section.

SEC. 162. Section 24416.5 of the Revenue and Taxation Code is amended to read:

24416.5. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1995, the term ''qualified taxpayer'' as used in Section 24416.1 includes a taxpayer engaged in the conduct of a trade or business within a LAMBRA. For purposes of this subdivision, all of the following shall apply:

(1) A net operating loss shall not be a net operating loss carryback for any ~~income~~ *taxable* year and, except as provided in subparagraph (B), a net operating loss for any ~~income~~ *taxable* year beginning on or after the date the area in which the taxpayer conducts a trade or business is designated a LAMBRA shall be a net operating loss carryover to each following ~~income~~ *taxable* year that ends before the LAMBRA expiration date or to each of the 15 ~~income~~ *taxable* years following the ~~income~~ *taxable* year of loss, if longer.

(2) In the case of a financial institution to which Section 585, 586, or 593 of the Internal Revenue Code applies, a net operating loss for any ~~income~~ *taxable* year beginning on or after January 1, 1984, shall be a net operating loss carryover to each of the five years following the ~~income~~ *taxable* year of the loss. Subdivision (b) of Section 24416.1 shall not apply.

(3) ''LAMBRA'' means a local agency military base recovery area designated in accordance with Section 7114 of the Government Code.

(4) ''Taxpayer'' means a bank or corporation that conducts a trade or business within a LAMBRA and, for the first two ~~income~~ *taxable* years, has a net increase in jobs (defined as 2,000 paid hours per employee per year) of one or more employees in the LAMBRA and this state. For purposes of this paragraph, all of the following shall apply:

(A) The net increase in the number of jobs shall be determined by subtracting the total number of full-time employees (defined as 2,000 paid hours per employee per year) the taxpayer employed in this state in the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA from the total number of full-time employees the taxpayer employed in this state during the second ~~income~~ *taxable* year after commencing business operations in the LAMBRA. For taxpayers who commence doing business in this state with their LAMBRA business operation, the number of employees for the ~~income~~ *taxable* year prior to commencing business operations in the LAMBRA shall be zero. The deduction

shall be allowed only if the taxpayer has a net increase in jobs in the state, and if one or more full-time employees are employed within the LAMBRA.

(B) The total number of employees employed in the LAMBRA shall equal the sum of both of the following:

(i) The total number of hours worked in the LAMBRA for the taxpayer by employees (not to exceed 2,000 hours per employee) who are paid an hourly wage divided by 2,000.

(ii) The total number of months worked in the LAMBRA for the taxpayer by employees who are salaried employees divided by 12.

(C) In the case of a taxpayer that first commences doing business in the LAMBRA during the ~~income~~ *taxable* year, for purposes of clauses (i) and (ii), respectively, of subparagraph (B) the divisors ''2,000'' and ''12'' shall be multiplied by a fraction, the numerator of which is the number of months of the ~~income~~ *taxable* year that the taxpayer was doing business in the LAMBRA and the denominator of which is 12.

(5) ''Net operating loss'' means the loss determined under Section 172 of the Internal Revenue Code, as modified by Section 24416.1, attributable to the taxpayer's business activities within a LAMBRA prior to the LAMBRA expiration date. The attributable loss shall be determined in accordance with Chapter 17 (commencing with Section 25101), modified for purposes of this section as follows:

(A) Loss shall be apportioned to a LAMBRA by multiplying total loss from the business by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is 2.

(B) ''The LAMBRA'' shall be substituted for ''this state.''

(6) A net operating loss carryover shall be a deduction only with respect to the taxpayer's business income attributable to a LAMBRA.

(7) Attributable income is that portion of the taxpayer's California source business income that is apportioned to the LAMBRA. For that purpose, the

taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the LAMBRA in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified as follows:

(A) Business income shall be apportioned to a LAMBRA by multiplying total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this clause:

(i) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the LAMBRA during the ~~income~~ *taxable* year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year.

(ii) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the LAMBRA during the ~~income~~ *taxable* year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ *taxable* year.

(B) If a loss carryover is allowable pursuant to this section for any ~~income~~ *taxable* year after the LAMBRA designation has expired, the LAMBRA shall be deemed to remain in existence for purposes of computing the limitation specified in subparagraph (D) and allowing a net operating loss deduction.

(8) ''LAMBRA expiration date'' means the date the LAMBRA designation expires, is no longer binding, or becomes inoperative pursuant to Section 7110 of the Government Code.

(b) A taxpayer who qualifies as a ''qualified taxpayer'' under one or more sections shall, for the ~~income~~ *taxable* year of the net operating loss and any ~~income~~ *taxable* year to which that net operating loss may be carried, designate on the original return filed for each year the section that

applies to that taxpayer with respect to that net operating loss. If the taxpayer is eligible to qualify under more than one section, the designation is to be made after taking into account subdivision (c).

(c) If a taxpayer is eligible to qualify under this section and either Section 24416.2, 24416.4, or 24416.6 as a ''qualified taxpayer,'' with respect to a net operating loss in ~~an income~~ *a taxable* year, the taxpayer shall designate which section is to apply to the taxpayer.

(d) Notwithstanding Section 24416, the amount of the loss determined under this section or Section 24416.2, 24416.4, or 24416.6 shall be the only net operating loss allowed to be carried over from that ~~income~~ *taxable* year and the designation under subdivision (b) shall be included in the election under Section 24416.1.

(e) This section shall apply to ~~income~~ *taxable* years beginning on and after January 1, 1998.

SEC. 163. Section 24416.6 of the Revenue and Taxation Code is amended to read:

24416.6. (a) For each ~~income~~ *taxable* year beginning on or after January 1, 1998, the term ''qualified taxpayer'' as used in Section 24416.1 includes a corporation that meets both of the following:

(1) Is engaged in the conduct of a trade or business within a targeted tax area designated pursuant to Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(2) Is engaged in those lines of business described in Codes 2000 to 2099, inclusive; 2200 to 3999, inclusive; 4200 to 4299, inclusive; 4500 to 4599, inclusive; and 4700 to 5199, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition. In the case of any pass-through entity, the determination of whether a taxpayer is a qualified taxpayer shall be made at the entity level.

(b) For purposes of subdivision (a), all of the following shall apply:

(1) A net operating loss shall not be a net operating loss carryback for any ~~income~~ *taxable* year and a net

operating loss for any ~~income~~ *taxable* year beginning on or after the date that the area in which the qualified taxpayer conducts a trade or business is designated as a targeted tax area shall be a net operating loss carryover to each of the 15 ~~income~~ *taxable* years following the ~~income~~ *taxable* year of loss.

(2) ''Net operating loss'' means the loss determined under Section 172 of the Internal Revenue Code, as modified by Section 24416.1, attributable to the qualified taxpayer's business activities within the targeted tax area (as defined in Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code) prior to the targeted tax area expiration date. That attributable loss shall be determined in accordance with Chapter 17 (commencing with Section 25101), modified for purposes of this section as follows:

(A) Loss shall be apportioned to the targeted tax area by multiplying total loss from the business by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is 2.

(B) ''The targeted tax area'' shall be substituted for ''this state.''

(3) A net operating loss carryover shall be a deduction only with respect to the qualified taxpayer's business income attributable to the targeted tax area as defined in Chapter 12.93 (commencing with Section 7097) of Division 7 of Title 1 of the Government Code.

(4) Attributable income is that portion of the taxpayer's California source business income that is apportioned to the targeted tax area. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the targeted tax area in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this subdivision as follows:

(A) Business income shall be apportioned to the targeted tax area by multiplying the total California business income of the taxpayer by a fraction, the

numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this clause:

(i) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the targeted tax area during the ~~income~~ *taxable* year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year.

(ii) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the targeted tax area during the ~~income~~ *taxable* year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the ~~income~~ *taxable* year.

(B) If a loss carryover is allowable pursuant to this subdivision for any ~~income~~ *taxable* year after the targeted tax area expiration date, the targeted tax area designation shall be deemed to remain in existence for purposes of computing the limitation specified in subparagraph (B) and allowing a net operating loss deduction.

(5) ''Targeted tax area expiration date'' means the date the targeted tax area designation expires, is revoked, is no longer binding, or becomes inoperative.

(c) A taxpayer who qualifies as a ''qualified taxpayer'' under one or more sections shall, for the ~~income~~ *taxable* year of the net operating loss and any ~~income~~ *taxable* year to which that net operating loss may be carried, designate on the original return filed for each year the section that applies to that taxpayer with respect to that net operating loss. If the taxpayer is eligible to qualify under more than one section, the designation is to be made after taking into account subdivision (e).

(d) If a taxpayer is eligible to qualify under this section and either Section 24416.2, 24416.4, or 24416.5 as a ''qualified taxpayer,'' with respect to a net operating loss in ~~an income~~ *a taxable* year, the taxpayer shall designate which section is to apply to the taxpayer.

(e) Notwithstanding Section 24416, the amount of the loss determined under this section or Section 24416.2, 24416.4, or 24416.5 shall be the only net operating loss allowed to be carried over from that ~~income~~ *taxable* year and the designation under subdivision (c) shall be included in the election under Section 24416.1.

(f) This section shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1998.

SEC. 164. 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~~ *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 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~~ *taxable* 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~~ *taxable* year ending on or after December 31,

1995, and all subsequent ~~income~~ *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 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~~ *taxable* 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~~ *four-taxable-year* period beginning with the ~~income~~ *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 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~~ *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 ~~income~~ *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 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. 165. Section 24425 of the Revenue and Taxation Code is amended to read:

24425. Any amount otherwise allowable as a deduction which is allocable to one or more classes of income not included in the measure of the tax imposed by this part, regardless of whether such income was received or accrued during the ~~income~~ *taxable* year.

SEC. 166. Section 24434 of the Revenue and Taxation Code is amended to read:

24434. (a) In the case of a taxpayer (other than a bank as defined in Section 23039) no deduction shall be allowed under Section 24347 or 24348 by reason of the worthlessness of any debt owed by a political party.

(b) (1) For purposes of subdivision (a), the term ‘‘political party’’ means any of the following:

(A) A political party.

(B) A national, state, or local committee of a political party.

(C) A committee, association, or organization which accepts contributions or makes expenditures for the purpose of influencing or attempting to influence the election of presidential or vice presidential electors or of any individual whose name is presented for election to any federal, state, or local elective public office, whether or not such individual is elected.

(2) For purposes of paragraph (1)(C), the term ‘‘contributions’’ includes a gift, subscription, loan, advance, or deposit, of money, or anything of value, and includes a contract, promise, or agreement to make a contribution, whether or not legally enforceable.

(3) For purposes of paragraph (1)(C), the term ‘‘expenditures’’ includes a payment, distribution, loan, advance, deposit, or gift, of money, or anything of value, and includes a contract, promise, or agreement to make an expenditure, whether or not legally enforceable.

(c) In the case of a taxpayer who uses an accrual method of accounting, subdivision (a) shall not apply to a debt which accrued as a receivable on a bona fide sale of goods or services in the ordinary course of a taxpayer’s trade or business if both of the following apply:

(1) For the ~~income~~ *taxable* year in which the receivable accrued, more than 30 percent of all receivables which accrued in the ordinary course of the trades or businesses of the taxpayer were due from political parties.

(2) The taxpayer made substantial continuing efforts to collect on the debt.

SEC. 167. Section 24436.1 of the Revenue and Taxation Code is amended to read:

24436.1. (a) In computing net income, no deductions (including deductions for cost of goods sold) shall be allowed to any taxpayer on any of its gross income directly derived from illegal activities as defined in Sections 266h or 266i of, or in Chapter 4 (commencing with Section 211) of Title 8 of, Chapter 7.5 (commencing with Section 311) of Title 9 of, Chapter 8 (commencing with Section 314) of Title 9 of, or Chapter 2 (commencing with Section 459), Chapter 5 (commencing with Section 484), or

Chapter 6 (commencing with Section 503) of Title 13 of, Part 1 of the Penal Code, or as defined in Chapter 6 (commencing with Section 11350) of Division 10 of the Health and Safety Code; nor shall any deductions be allowed to any taxpayer on any of its gross income derived from any other activities which directly tend to promote or to further, or are directly connected or associated with, those illegal activities.

(b) A prior, final determination by a court of competent jurisdiction of this state in any criminal proceedings or any proceeding in which the state, county, city and county, city, or other political subdivision was a party thereto on the merits of the legality of the activities of a taxpayer or predecessor in interest of a taxpayer shall be binding upon the Franchise Tax Board and the State Board of Equalization.

(c) This section shall be applied with respect to ~~income~~ *taxable* years which have not been closed by a statute of limitations, res judicata, or otherwise.

SEC. 168. Section 24436.5 of the Revenue and Taxation Code is amended to read:

24436.5. (a) No deduction shall be allowed for interest, depreciation, taxes, or amortization paid or incurred in the ~~income~~ *taxable* year under Section 24343, 24344, 24345, or 24349, with respect to substandard housing located in this state, except as provided in subdivision (e).

(b) ‘‘Substandard housing’’ means occupied dwellings from which the taxpayer derives rental income or unoccupied or abandoned dwellings for which both of the following apply:

(1) Either of the following occurs:

(A) For occupied dwellings from which the taxpayer derives rental income, a state or local government regulatory agency has determined that the housing violates state law or local codes dealing with health, safety, or building.

(B) For dwellings that are unoccupied or abandoned for at least 90 days, a state or local government regulatory agency has cited the housing for conditions that

constitute a serious violation of state law or local codes dealing with health, safety, or building, and that constitute a threat to public health and safety.

(2) Either of the following occurs:

(A) After written notice of violation by the regulatory agency, specifying the applicability of this section, the housing has not been repaired or brought to a condition of compliance within six months after the date of the notice or the time prescribed in the notice, whichever period is later.

(B) Good faith efforts for compliance have not been commenced, as determined by the regulatory agency.

''Substandard housing'' also means employee housing that has not, within 30 days of the date of the written notice of violation or the date for compliance prescribed in the written notice of violation, been brought into compliance with the conditions stated in the written notice of violation of the Employee Housing Act (Part 1 (commencing with Section 17000) of Division 13 of the Health and Safety Code) issued by the enforcement agency that specifies the application of this section. The regulatory agency may, for good cause shown, extend the compliance date prescribed in a violation notice.

(c) (1) When the period specified in paragraph (2) of subdivision (b) has expired without compliance, the government regulatory agency shall mail to the taxpayer a notice of noncompliance. The notice of noncompliance shall be in a form and shall include information prescribed by the Franchise Tax Board, shall be mailed by certified mail to the taxpayer at his or her last known address, and shall advise the taxpayer of (A) an intent to notify the Franchise Tax Board of the noncompliance within 10 days unless an appeal is filed, (B) where an appeal may be filed, and (C) a general description of the tax consequences of that filing with the Franchise Tax Board. Appeals shall be made to the same body and in the same manner as appeals from other actions of the regulatory agency. If no appeal is made within 10 days or if after disposition of the appeal the regulatory agency is

sustained, the regulatory agency shall notify, in writing, the Franchise Tax Board of the noncompliance.

(2) The notice of noncompliance shall contain the legal description or the lot and block numbers of the real property, the assessor's parcel number, and the name of the owner of record as shown on the latest equalized assessment roll. In addition, the regulatory agency shall, at the same time as notification of the notice of noncompliance is sent to the Franchise Tax Board, record a copy of the notice of noncompliance in the office of the recorder for the county in which the substandard housing is located that includes a statement of tax consequences that may be determined by the Franchise Tax Board. However, the failure to record a notice with the county recorder does not relieve the liability of any taxpayer nor does it create any liability on the part of the regulatory agency.

(3) The regulatory agency may charge the taxpayer a fee in an amount not to exceed the regulatory agency's costs incurred in recording any notice of noncompliance or issuing any release of that notice. The notice of compliance shall be recorded and shall serve to expunge the notice of noncompliance. The notice of compliance shall contain the same recording information required for the notice of noncompliance. No deduction by the taxpayer, or any other taxpayer who obtains title to the property subsequent to the recordation of the notice of noncompliance, shall be allowed for the items provided in subdivision (a) from the date of the notice of noncompliance until the date the regulatory agency determines that the substandard housing has been brought to a condition of compliance. The regulatory agency shall mail to the Franchise Tax Board and the taxpayer a notice of compliance, which notice shall be in the form and include the information prescribed by the Franchise Tax Board. In the event the period of noncompliance does not cover an entire ~~income~~ *taxable* year, the deductions shall be denied at the rate of $^{1}/_{12}$ for each full month during the period of noncompliance.

(4) If the property is owned by more than one owner or the recorded title is in the name of a fictitious owner, the notice requirements provided in subdivision (b) and this subdivision shall be satisfied for each owner if the notices are mailed to one owner or to the fictitious name owner at the address appearing on the latest available property tax bill. However, notices made pursuant to this subdivision shall not relieve the regulatory agency from furnishing taxpayer identification information required to implement this section to the Franchise Tax Board.

(d) For the purposes of this section, a notice of noncompliance shall not be mailed by the regulatory agency to the Franchise Tax Board if any of the following occur:

(1) The housing was rendered substandard solely by reason of earthquake, flood or other natural disaster except where the condition remains for more than three years after the disaster.

(2) The owner of the substandard housing has secured financing to bring the housing into compliance with those laws or codes that have been violated, causing the housing to be classified as substandard, and has commenced repairs or other work necessary to bring the housing into compliance.

(3) The owner of substandard housing that is not within the meaning of housing accommodation, as defined in subdivision (d) of Section 35805 of the Health and Safety Code, has done both of the following:

(A) Attempted to secure financing to bring the housing into compliance with those laws or codes that have been violated, causing the housing to be classified as substandard.

(B) Been denied that financing solely because the housing is located in a neighborhood or geographical area in which financial institutions do not provide financing for rehabilitation of any of that type of housing.

(e) The provisions of this section do not apply to deductions from income derived from property rendered substandard solely by reason of a change in applicable state or local housing standards unless those violations

cause substantial danger to the occupants of the property, as determined by the regulatory agency which has served notice of violation pursuant to subdivision (b).

(f) The owner of substandard housing found to be in noncompliance shall, upon total or partial divestiture of interest in the property, immediately notify the regulatory agency of the name and address of the person or persons to whom the property has been sold or otherwise transferred and the date of the sale or transference.

(g) By July 1 of each year, the regulatory agency shall report to the appropriate legislative body of its jurisdiction all of the following information, for the preceding calendar year, regarding its activities to secure code enforcement, which shall be public information:

(1) The number of written notices of violation issued for substandard housing under subdivision (b).

(2) The number of violations complied with within the period prescribed in subdivision (b).

(3) The number of notices of noncompliance issued pursuant to subdivision (c).

(4) The number of appeals from those notices pursuant to subdivision (c).

(5) The number of successful appeals by owners.

(6) The number of notices of noncompliance mailed to the Franchise Tax Board pursuant to subdivision (c).

(7) The number of cases in which a notice of noncompliance was not sent pursuant to the provisions of subdivision (d).

(8) The number of extensions for compliance granted pursuant to subdivision (b) and the mean average length of the extensions.

(9) The mean average length of time from the issuance of a notice of violation to the mailing of a notice of noncompliance to the Franchise Tax Board where the notice is actually sent to the Franchise Tax Board.

(10) The number of cases where compliance is achieved after a notice of noncompliance has been mailed to the Franchise Tax Board.

(11) The number of instances of disallowance of tax deductions by the Franchise Tax Board resulting from referrals made by the regulatory agency. This information may be filed in a supplemental report in succeeding years as it becomes available.

(h) The provisions of this section relating to substandard housing consisting of abandoned or unoccupied dwellings do not apply to any lender engaging in a ‘‘federally related transaction,’’ as defined in Section 11302 of the Business and Professions Code, who acquires title through judicial or nonjudicial foreclosure, or accepts a deed in lieu of foreclosure. The exception provided in this subdivision covers only substandard housing consisting of abandoned or unoccupied dwellings involved in the federally related transaction.

SEC. 169. Section 24438 of the Revenue and Taxation Code is amended to read:

24438. (a) No deduction shall be allowed for any interest paid or incurred by a taxpayer during the ~~income~~ *taxable* year with respect to its corporate acquisition indebtedness to the extent that such interest exceeds—

(1) Five million dollars ($5,000,000), reduced by

(2) The amount of interest paid or incurred by such corporation during such year on obligations (A) issued after December 31, 1967, to provide consideration for an acquisition described in paragraph (1) of subdivision (b), but (B) which are not corporate acquisition indebtedness.

(b) For purposes of this section, the term ‘‘corporate acquisition indebtedness’’ means any obligation evidenced by a bond, debenture, note, or certificate or other evidence of indebtedness issued after October 9, 1969, by a corporation (hereinafter in this section referred to as ‘‘issuing corporation’’) if—

(1) Such obligation is issued to provide consideration for the acquisition of—

(A) Stock in another corporation (hereinafter in this section referred to as ‘‘acquired corporation’’), or

(B) Assets of another corporation (hereinafter in this section referred to as ‘‘acquired corporation’’) pursuant to a plan under which at least two-thirds (in value) of all the assets (excluding money) used in trades and businesses carried on by such corporation are acquired,

(2) Such obligation is either—

(A) Subordinated to the claims of trade creditors of the issuing corporation generally, or

(B) Expressly subordinated in right of payment to the payment of any substantial amount of unsecured indebtedness, whether outstanding or subsequently issued, of the issuing corporation,

(3) The bond or other evidence of indebtedness is either—

(A) Convertible directly or indirectly into stock of the issuing corporation, or

(B) Part of an investment unit or other arrangement which includes, in addition to such bond or other evidence of indebtedness, an option to acquire, directly or indirectly, stock in the issuing corporation, and

(4) As of a day determined under paragraph (1) of subdivision (c) either—

(A) The ratio of debt to equity (as defined in paragraph (2) of subdivision (c)) of the issuing corporation exceeds 2 to 1, or

(B) The projected earnings (as defined in paragraph (3) of subdivision (c)), do not exceed three times the annual interest to be paid or incurred (determined under paragraph (4) of subdivision (c)).

(c) For purposes of paragraph (4) of subdivision (b)—

(1) Determinations are to be made as of the last day of any ~~income~~ *taxable* year of the issuing corporation in which it issues any obligation to provide consideration for an acquisition described in paragraph (1) of subdivision (b) of stock in, or assets of, the acquired corporation.

(2) The term ‘‘ratio of debt to equity’’ means the ratio which the total indebtedness of the issuing corporation bears to the sum of its money and all its other assets (in an amount equal to their adjusted basis for determining gain) less such total indebtedness.

(3) (A) The term ‘‘projected earnings’’ means the ‘‘average annual earnings’’ (as defined in subparagraph (B)) of—

(i) The issuing corporation only, if cause (ii) does not apply, or

(ii) Both the issuing corporation and the acquired corporation, in any case where the issuing corporation has acquired control (as defined in Section 24564), or has acquired substantially all of the properties of the acquired corporation.

(B) The average annual earnings referred to in subparagraph (A) is, for any corporation, the amount of its earnings and profits for any three-year period ending with the last day of ~~an income~~ *a taxable* year of the issuing corporation described in paragraph (1), computed without reduction for—

(i) Interest paid or incurred,

(ii) Depreciation or amortization allowed under this part,

(iii) Liability for tax under this part, and

(iv) Distributions to which Section 301(c)(1) of the Internal Revenue Code, relating to property distributions, applies (other than such distributions from the acquired to the issuing corporation), and reduced to an annual average for such three-year period pursuant to regulations prescribed by the Franchise Tax Board. Such regulations shall include rules for cases where any corporation was not in existence for all of such three-year period or such period includes only a portion of ~~an income~~ *a taxable* year of any corporation.

(4) The term ‘‘annual interest to be paid or incurred’’ means—

(A) If subparagraph (B) does not apply, the annual interest to be paid or incurred by the issuing corporation only, determined by reference to its total indebtedness outstanding, or

(B) If projected earnings are determined under clause (ii) of subparagraph (A) of paragraph (3), the annual interest to be paid or incurred by both the issuing corporation and the acquired corporation, determined by

reference to their combined total indebtedness outstanding.

(5) With respect to any corporation which is a bank or is primarily engaged in a lending or finance business—

(A) In determining under paragraph (2) the ratio of debt to equity of such corporation (or of the affiliated group of which such corporation is a member), the total indebtedness of such corporation (and the assets of such corporation) shall be reduced by an amount equal to the total indebtedness owed to such corporation which arises out of the banking business of such corporation, or out of the lending or finance business of such corporation, as the case may be;

(B) In determining under paragraph (4) the annual interest to be paid or incurred by such corporation (or by the issuing and acquired corporations referred to in subparagraph (B) of paragraph (4) or by the affiliated group of which such corporation is a member) the amount of such interest (determined without regard to this paragraph) shall be reduced by an amount which bears the same ratio to the amount of such interest as the amount of the reduction for the ~~income~~ *taxable* year under subparagraph (A) bears to the total indebtedness of such corporation; and

(C) In determining under subparagraph (B) of paragraph (3), the average annual earnings, the amount of the earnings and profits for the three-year period shall be reduced by the sum of the reductions under subparagraph (B) for such period.

For purposes of this paragraph, the term ‘‘lending or finance business’’ means a business of making loans or purchasing or discounting accounts receivable, notes, or installment obligations.

(d) In applying this section—

(1) The deduction of interest on any obligation shall not be disallowed under subdivision (a) before the first ~~income~~ *taxable* year of the issuing corporation as of the last day of which the application of either subparagraph (A) or subparagraph (B) of paragraph (4) of subdivision

(b) results in such obligation being corporate acquisition indebtedness.

(2) Except as provided in paragraphs (3), (4), and (5), if an obligation is determined to be corporate acquisition indebtedness as of the last day of any ~~income~~ *taxable* year of the issuing corporation, it shall be corporate acquisition indebtedness for such ~~income~~ *taxable* year and all subsequent ~~income~~ *taxable* years.

(3) If an obligation is determined to be corporate acquisition indebtedness as of the close of ~~an income~~ *a taxable* year of the issuing corporation in which clause (i) of subparagraph (A) of paragraph (3) of subdivision (c) applied, but would not be corporate acquisition indebtedness if the determination were made as of the close of the first ~~income~~ *taxable* year of such corporation thereafter in which clause (ii) of subparagraph (A) of paragraph (3) of subdivision (c) could apply, such obligation shall be considered not to be corporate acquisition indebtedness for such later ~~income~~ *taxable* year and all ~~income~~ *taxable* years thereafter.

(4) If an obligation which has been determined to be corporate acquisition indebtedness for any ~~income~~ *taxable* year would not be such indebtedness for each of any three consecutive ~~income~~ *taxable* years thereafter if paragraph (4) of subdivision (b) were applied as of the close of each of such three years, then such obligation shall not be corporate acquisition indebtedness for all ~~income~~ *taxable* years after such three consecutive ~~income~~ *taxable* years.

(5) In the case of obligations issued to provide consideration for the acquisition of stock in another corporation, such obligations shall be corporate acquisition indebtedness for ~~an income~~ *a taxable* year only if the issuing corporation owns 5 percent or more of the total combined voting power of all classes of stock entitled to vote of such other corporation.

(e) An acquisition of stock of a corporation of which the issuing corporation is in control (as defined in Section 24564) in a transaction in which gain or loss is not recognized shall be deemed an acquisition described in

paragraph (1) of subdivision (b) only if immediately before such transaction (1) the acquired corporation was in existence, and (2) the issuing corporation was not in control (as defined in Section 24564) of such corporation.

(f) For purposes of this section, the term ‘‘corporate acquisition indebtedness’’ does not include any indebtedness issued to any person to provide consideration for the acquisition of stock in, or assets of, any foreign corporation substantially all of the income of which, for the three-year period ending with the date of such acquisition or for such part of such period as the foreign corporation was in existence, is from sources without the United States.

(g) In any case in which the issuing corporation is a member of an affiliated group, the application of this section shall be determined, pursuant to regulations prescribed by the Franchise Tax Board, by treating all of the members of the affiliated group in the aggregate as the issuing corporation, except that the ratio of debt to equity of, projected earnings of, and annual interest to be paid or incurred by any corporation (other than the issuing corporation determined without regard to this subdivision) shall be included in the determinations required under subparagraphs (A) and (B) of paragraph (4) of subdivision (b) as of any day only if such corporation is a member of the affiliated group on such day, and, in determining projected earnings of such corporation under paragraph (3) of subdivision (c), there shall be taken into account only the earnings and profits of such corporation for the period during which it was a member of the affiliated group. For purposes of this section, the term ‘‘affiliated group’’ has the meaning assigned to such term by Section 1504 of the Internal Revenue Code except that all corporations other than the acquired corporation shall be treated as includable corporations and the acquired corporation shall not be treated as an includable corporation.

(h) For purposes of this section—

(1) Any extension, renewal, or refinancing of an obligation evidencing a preexisting indebtedness shall not be deemed to be the issuance of a new obligation.

(2) Any obligation which is corporate acquisition indebtedness of the issuing corporation is also corporate acquisition indebtedness of any corporation which becomes liable for such obligation as guarantor, endorser, or indemnitor or which assumes liability for such obligation in any transaction.

(i) No inference shall be drawn from any provision in this section that any instrument designated as a bond, debenture, note, or certificate or other evidence of indebtedness by its issuer represents an obligation or indebtedness of such issuer in applying any other provision of this part.

(j) This section shall apply to the determination of the allowability of the deduction of interest paid or incurred with respect to indebtedness incurred after December 31, 1970.

SEC. 170. Section 24442.5 of the Revenue and Taxation Code is amended to read:

24442.5. Section 280H of the Internal Revenue Code, relating to limitation on certain amounts paid to employee-owners by personal service corporations electing alternative taxable years, shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1989, except as otherwise provided.

SEC. 171. Section 24448 of the Revenue and Taxation Code is amended to read:

24448. (a) Notwithstanding any other provisions in this part, in the case of a taxpayer who owns real property and has either failed to provide the information required pursuant to Section 18642 or has provided information which is either false, misleading, or incomplete in the information return required pursuant to Section 18642, no deduction for interest, taxes, depreciation, or amortization under Section 24343, 24344, 24345, 24349, or 24354.2 shall be allowed which relate to that real property, as provided in subdivision (b).

(b) No deduction shall be allowed for the items provided in subdivision (a) from 60 days after the due date for filing the information return required pursuant to Section 18642 until the date the Franchise Tax Board determines that all provisions of Section 18642 have been complied with.

(c) In the event the period of noncompliance does not cover an entire ~~income~~ *taxable* year, the deductions shall be denied at the rate of one-twelfth for each full month during the period of noncompliance.

SEC. 172. Section 24602 of the Revenue and Taxation Code is amended to read:

24602. (a) In addition to the application of Part II (commencing with Section 421) of Subchapter D of Chapter 1 of Subtitle A of the Internal Revenue Code, relating to certain stock options, paragraphs (1), (2), and (3) of Section 421(a) of the Internal Revenue Code shall also apply to any California qualified stock option that is granted to an individual whose earned income from the corporation granting the California qualified stock option for the ~~income~~ *taxable* year in which that option is exercised does not exceed forty thousand dollars ($40,000). In the event that the option does not meet the necessary qualifications, the option shall be treated as a nonqualified stock option.

(b) For purposes of this section, ‘‘California qualified stock option’’ means a stock option that is issued and exercised pursuant to this section and that is designated by the corporation issuing the option as a California qualified stock option at the time the option is granted.

(c) (1) This section shall apply only to those stock options that are issued on or after January 1, 1997, and before January 1, 2002, by a corporation to its employee and are exercised by the employee, while employed by the corporation that issued those stock options (or within three months thereof, or within one year thereof if permanently and totally disabled as defined in Section 22(e)(3) of the Internal Revenue Code), during the ~~income~~ *taxable* year with respect to any class of shares, or combination thereof, issued by the corporation, to the

extent that the number of shares transferable by the exercise of the options does not exceed a total of 1,000 and have a combined fair market value of less than one hundred thousand dollars ($100,000). The combined fair market value of any stock shall be determined as of the time the option with respect to that stock is granted.

(2) Paragraph (1) shall be applied by taking options into account in the order in which they were granted.

(d) In the case of a California qualified stock option, no amount shall be included in the gross income of the employee until the time of the disposition of the option (or the stock acquired upon exercise of the option). No deduction shall be allowed under Section 162 of the Internal Revenue Code to the employer on the grant or exercise of a California qualified stock option.

(e) Subdivision (d) shall not apply to any stock option for which an election has been made under Section 83(b) of the Internal Revenue Code, relating to election to include in gross income in year of transfer.

SEC. 173. 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~~ *taxable* years beginning on or after January 1, 1995.

(b) For ~~income~~ *taxable* 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~~ *taxable* 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. 174. Section 24631 of the Revenue and Taxation Code is amended to read:

24631. (a) ~~Income~~ *(1) For taxable years beginning prior to January 1, 2000, income* shall be computed on the basis of the taxpayer's income year.

(2) For taxable years beginning on or after January 1, 2000 (other than the first taxable year beginning on or after that date), income shall be computed on the basis of the taxpayer's taxable year.

(3) As provided in paragraph (1) of subdivision (f) of Section 23151, paragraph (1) of subdivision (f) of Section 23181, and paragraph (1) of subdivision (c) of Section 23183, for the first taxable year beginning on or after January 1, 2000, income shall be computed on the basis of both the preceding income year and the current taxable year.

(b) For purposes of this part, the term ''income year'' *or "taxable year" (as applicable)* means—

(1) The taxpayer's annual accounting period, if it is a calendar year or a fiscal year;

(2) The calendar year, if subsection (g) applies; or

(3) The period for which the return is made, if a return is made for a period of less than 12 months.

(c) For purposes of this part, the term ''annual accounting period'' means the annual period on the basis of which the taxpayer regularly computes its income in keeping its books.

(d) For purposes of this part, the term ''calendar year'' means a period of 12 months ending on December 31st.

(e) For purposes of this part, the term ''fiscal year'' means a period of 12 months ending on the last day of any month other than December. In the case of any taxpayer who has made the election provided by subsection (f), the term means the annual period (varying from 52 to 53 weeks) so elected.

(f) (1) A taxpayer who, in keeping its books, regularly computes its income on the basis of an annual period which varies from 52 to 53 weeks and ends always on the same day of the week and ends always—

(A) On whatever date such same day of the week last occurs in a calendar month, or

(B) On whatever date such same day of the week falls which is nearest to the last day of a calendar month,

may (in accordance with the regulations prescribed under paragraph (3)) elect to compute its income for purposes of this part on the basis of such annual period. This paragraph shall apply to ~~income~~ *taxable* years ending after December 31, 1954.

(2) (A) In any case in which the effective date or the applicability of any provision of this part is expressed in terms of ~~income~~ *taxable* years beginning or ending with reference to a specified date which is the first or last day of a month, ~~an income~~ *a taxable* year described in paragraph (1) shall be treated—

(i) As beginning with the first day of the calendar month beginning nearest to the first day of such ~~income~~ *taxable* year, or

(ii) As ending with the last day of the calendar month ending nearest to the last day of such ~~income~~ *taxable* year, as the case may be.

(B) In the case of a change from or to ~~an income~~ *a taxable* year described in paragraph (1)—

(i) If such change results in a short period (within the meaning of Section 24634) of 359 days or more, or less than seven days, Section 24636 shall not apply;

(ii) If such change results in a short period of less than seven days, such short period shall, for purposes of this part, be added to and deemed a part of the following ~~income~~ *taxable* year; and

(iii) If such change results in a short period to which Section 24634 applies, the income for such short period shall be placed on an annual basis for purposes of such subsection by multiplying such income by 365 and dividing the result by the number of days in a short period, and the tax shall be the same part of the tax computed on the annual basis as the number of days in the short period is of 365 days.

(3) The Franchise Tax Board shall prescribe such regulations as it deems necessary for the application of this subsection.

(g) Except as provided in Section 24634 (relating to returns for periods of less than 12 months), the taxpayer's ~~income~~ *taxable* year shall be the calendar year if—

(1) The taxpayer keeps no books;

(2) The taxpayer does not have an annual accounting period; or

(3) The taxpayer has an annual accounting period, but such period does not qualify as a fiscal year.

SEC. 175. Section 24632 of the Revenue and Taxation Code is amended to read:

24632. The ~~income~~ *taxable* year of a taxpayer may not be different than the taxable year used for purposes of the Internal Revenue Code, unless initiated or approved by the Franchise Tax Board, or otherwise required under Section 24634.

SEC. 176. Section 24633 of the Revenue and Taxation Code is amended to read:

24633. If a taxpayer changes its annual accounting period, the new accounting period shall become the taxpayer's ~~income~~ *taxable* year only if the change is approved by the Franchise Tax Board. For purposes of this part, if a taxpayer to whom Section 24631(g) applies adopts an annual accounting period (as defined in Section 24631(c)) other than a calendar year, the taxpayer shall be treated as having changed its annual accounting period.

SEC. 177. Section 24633.5 of the Revenue and Taxation Code is amended to read:

24633.5. (a) In the case of any ''S corporation'' or personal service corporation required to change its accounting period by the federal Tax Reform Act of 1986 (Public Law 99-514) as modified by Section 10206 of Public Law 100-203 and Section 1008(e) of Public Law 100-647, that change shall be treated as initiated by the ''S corporation'' or personal service corporation with the consent of the Franchise Tax Board.

(b) With respect to any beneficiary, partner, or shareholder which is required to include the items from more than one taxable ~~(or income)~~ year of the trust, partnership, or corporation in any one ~~income~~ *taxable*

year, any income in excess of expenses for the short ~~income~~ *taxable* year resulting from the change described in subdivision (a) or subdivision (a) of Section 17551.5 shall be taken into account ratably in each of the first four ~~income~~ *taxable* years beginning after December 31, 1986, unless the beneficiary, partner, or shareholder elects to include all that income in the beneficiary's, partner's, or shareholder's ~~income~~ *taxable* year with or within which the trust's, partnership's, or corporation's short taxable ~~(or income)~~ year ends.

(c) The spreading of income over four years, as allowed by subdivision (b), shall not apply unless the taxpayer receives similar treatment for federal income tax purposes.

(d) For ~~income~~ *taxable* years beginning on or after January 1, 1987, each of the following shall apply:

(1) The adjusted basis of any partner's interest in a partnership or shareholder's stock in an ''S corporation'' shall be determined as if all of the income to be taken into account ratably in the four ~~income~~ *taxable* years referred to in subdivision (b) were included in gross income for the first of those ~~income~~ *taxable* years.

(2) If any interest in a partnership or stock in an ''S corporation'' is disposed of before the last ~~income~~ *taxable* year in the spread period, all amounts which would be included in the gross income of the partner or shareholder for subsequent ~~income~~ *taxable* years in the spread period under subdivision (b) and attributable to the interest or stock disposed of shall be included in gross income for the ~~income~~ *taxable* year in which the disposition occurs. For purposes of the preceding sentence, the term ''spread period'' means the period consisting of the four ~~income~~ *taxable* years referred to in subdivision (b).

SEC. 178. Section 24634 of the Revenue and Taxation Code is amended to read:

24634. (a) A return for a period of less than 12 months (referred to in this article as ''short period'') shall be made under any of the following circumstances:

(1) When the taxpayer, with the approval of the Franchise Tax Board, changes its annual accounting period. In such a case, the return shall be made for the short period beginning on the day after the close of the former ~~income~~ *taxable* year and ending at the close of the day before the day designated as the first day of the new ~~income~~ *taxable* year.

(2) When the taxpayer is in existence during only part of what would otherwise be its ~~income~~ *taxable* year, except if the taxpayer's existence terminates as a result of a reorganization described in Section 368(a)(1)(F) of the Internal Revenue Code.

(3) When the Franchise Tax Board terminates the taxpayer's ~~income~~ *taxable* year under Sections 19081 and 19082 (relating to tax in jeopardy).

(4) When the taxpayer is required to make a federal return for a period of less than 12 months.

(b) This section shall apply whether or not a federal return is required to be filed for a period of less than 12 months.

(c) If a return is required to be filed under this section for a period of less than 12 months, that period shall be deemed to be ~~an income~~ *a taxable* year.

SEC. 179. Section 24636 of the Revenue and Taxation Code is amended to read:

24636. (a) If a separate return is made by a taxpayer subject to the tax imposed by Chapter 2, under Section 24634 on account of a change in the accounting period the net income, computed on the basis of the period for which the separate return is made, referred to in this section as "the short period," shall be placed on an annual basis by multiplying the amount thereof by 12, and dividing by the number of months in the short period. The Franchise Tax Board shall compute the amount of a tax on the income placed on such annual basis, and shall allow the offset provided for in Article 3 of Chapter 2, from such tax. The tax due under this section, which shall not be subject of offset, shall be such part of the tax, less the offset allowed, computed on such annual basis as the number of months in the short period is of 12 months.

(b) If a taxpayer subject to the tax imposed by Chapter 2 establishes the amount of its net income for the period of 12 months beginning with the first day of the short period, computed as if such 12-month period were ~~an income~~ *a taxable* year, under the law applicable to such year, then the tax for the short period shall be reduced to an amount which is such part of the tax computed on the net income for such 12-month period as the net income computed on the basis of the short period is of the net income for the 12-month period. The taxpayer (other than a taxpayer to which the next sentence applies) shall compute the tax and file its return without the application of this section. If the taxpayer has disposed of substantially all its assets prior to the end of such 12-month period, then in lieu of the net income for such 12-month period there shall be used for the purposes of this section the net income for the 12-month period ending with the last day of the short period. The tax computed under this section shall in no case be less than the tax computed on the net income for the short period without placing such net income on an annual basis. The benefits of this section shall not be allowed unless the taxpayer, at such time as regulations prescribed hereunder require (but not after the time prescribed for the filing of the return for the first ~~income~~ *taxable* year which ends on or after 12 months after the beginning of the short period), makes application therefor in accordance with such regulations. Such application, in case the return was filed without regard to this section, shall be considered a claim for credit or refund with respect to the amount by which the tax is reduced under this section. The Franchise Tax Board shall prescribe such regulations as it may deem necessary for the application of this section.

(c) In the case of a taxpayer required to file a short period return pursuant to Section 24634, the alternative minimum tax shall be determined in accordance with Section 443(d) of the Internal Revenue Code.

SEC. 180. Section 24637 of the Revenue and Taxation Code is amended to read:

24637. For ~~income~~ *taxable* years beginning on or after January 1, 1987, Section 444 of the Internal Revenue Code, relating to election of taxable year other than required taxable year, shall be applicable, except that Section 444(c)(1), relating to effect of election, shall not apply.

SEC. 181. Section 24654 of the Revenue and Taxation Code is amended to read:

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

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

SEC. 182. Section 24667 of the Revenue and Taxation Code is amended to read:

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

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

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

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

(c) In the case of any taxpayer who made sales under a revolving credit plan and was on the installment method under former Section 24667 or 24668 for the

taxpayer's last ~~income~~ *taxable* year beginning before January 1, 1988, the provisions of this section shall be treated as a change in method of accounting for the first ~~income~~ *taxable* year beginning after December 31, 1987, and all of the following shall apply:

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

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

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

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

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

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

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

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

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

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

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

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

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

(3) The provisions of Section 453A(c)(3)(B) of the Internal Revenue Code, relating to the maximum rate used in calculating the deferred tax liability, are modified to refer to the maximum rate of tax imposed under Section 23151, 23186, or 23802, whichever applies, in lieu of the maximum rate of tax imposed under Section 1 or 11 of the Internal Revenue Code.

SEC. 183. 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~~ *taxable* years beginning on or after January 1, 1987.

(2) In the case of a contract entered into after February 28, 1986, during ~~an income~~ *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 ~~income~~ *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 each ~~income~~ *taxable* year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after October 13, 1987, during ~~an income~~ *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 state and federal law for each ~~income~~ *taxable* 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~~ *taxable* year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after June 20, 1988, during ~~an income~~ *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 state and federal law for each ~~income~~ *taxable* 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~~ *taxable* year beginning on or after January 1, 1990.

(2) In the case of a contract entered into after July 10, 1989, during ~~an income~~ *a taxable* 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~~ *taxable* 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~~ *taxable* year from which the adjustment arose, rather than the ~~income~~ *taxable* year in which the contract was completed.

SEC. 184. Section 24674 of the Revenue and Taxation Code is amended to read:

24674. (a) If, in the case of a taxpayer owning any non-interest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals the increase in the redemption price of such obligation occurring in the ~~income~~ *taxable* year does not (under the method of accounting used in computing its income) constitute income to it in such year, such taxpayer may, at its election made in its return for any ~~income~~ *taxable* year, treat such increase as income received in such ~~income~~ *taxable* year. If any such election is made with respect to any such obligation, it shall apply also to all such obligations owned by the taxpayer at the beginning of the first ~~income~~ *taxable* year to which it applies and to all such obligations thereafter acquired by it and shall be binding for all subsequent ~~income~~ *taxable* years, unless on application by the taxpayer the Franchise Tax Board permits it, subject to such conditions as the Franchise Tax Board deems necessary, to change to a different method.

(b) In the case of any obligation—

(1) Of the United States; or

(2) Of a state, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia, which is issued on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, the amount of discount at which such obligation is originally sold shall not be considered to accrue until the

date on which such obligation is paid at maturity, sold, or otherwise disposed of.

SEC. 185. Section 24675 of the Revenue and Taxation Code is amended to read:

24675. If an amount representing compensatory damages is received or accrued by a taxpayer during ~~an income~~ *a taxable* year as the result of an award in a civil action for infringement of a patent issued by the United States, then the tax attributable to the inclusion of such amount in gross income for the ~~income~~ *taxable* year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during which such infringement occurred.

SEC. 186. Section 24676 of the Revenue and Taxation Code is amended to read:

24676. (a) Prepaid subscription income to which this section applies shall be included in gross income for the ~~income~~ *taxable* years during which the liability described in subsection (d)(2) exists.

(b) In the case of any prepaid subscription income to which this section applies—

(1) If the liability described in subsection (d)(2) ends, then so much of such income as was not includable in gross income under subsection (a) for preceding ~~income~~ *taxable* years shall be included in gross income for the ~~income~~ *taxable* year in which the liability ends.

(2) If the taxpayer ceases to be subject to tax measured by net income imposed under Chapter 2 (commencing at Section 23101) or Chapter 3 (commencing at Section 23501) of this part, then so much of such income as was not includable in gross income under subsection (a) for preceding ~~income~~ *taxable* years shall be included in the measure of tax for the last year in which the taxpayer is subject to the tax measured by net income imposed under Chapter 2 or Chapter 3 of this part.

(c) (1) This section shall apply to prepaid subscription income if and only if the taxpayer makes an election under this section with respect to the trade or business in connection with which such income is

received. The election shall be made in such manner as the Franchise Tax Board may by regulations prescribe. No election may be made with respect to a trade or business if in computing net income the cash receipts and disbursements method of accounting is used with respect to such trade or business.

(2) An election made under this section shall apply to all prepaid subscription income received in connection with the trade or business with respect to which the taxpayer has made the election; except that the taxpayer may, to the extent permitted under regulations prescribed by the Franchise Tax Board, include in gross income for the ~~income~~ *taxable* year of receipt the entire amount of any prepaid subscription income if the liability from which it arose is to end within 12 months after the date of receipt. An election made under this section shall not apply to any prepaid subscription income received before the first ~~income~~ *taxable* year for which the election is made.

(3) (A) A taxpayer may, with the consent of the Franchise Tax Board, make an election under this section at any time.

(B) A taxpayer may, without the consent of the Franchise Tax Board, make an election under this section for his first ~~income~~ *taxable* year (i) which begins after December 31, 1960, and (ii) in which it receives prepaid subscription income in the trade or business. Such election shall be made not later than the time prescribed by law for filing the return for the ~~income~~ *taxable* year (including extensions thereof) with respect to which such election is made.

(4) An election under this section shall be effective for the ~~income~~ *taxable* year with respect to which it is first made and for all subsequent ~~income~~ *taxable* years, unless the taxpayer secures the consent of the Franchise Tax Board to the revocation of such election. For purposes of this part, the computation of net income under an election made under this section shall be treated as a method of accounting.

(d) For purposes of this section—

(1) The term ‘‘prepaid subscription income’’ means any amount (includable in gross income) which is received in connection with, and is directly attributable to, a liability which extends beyond the close of the ~~income~~ *taxable* year in which such amount is received, and which is income from a subscription to a newspaper, magazine, or other periodical.

(2) The term ‘‘liability’’ means a liability to furnish or deliver a newspaper, magazine, or other periodical.

(3) Prepaid subscription income shall be treated as received during the ~~income~~ *taxable* year for which it is includable in gross income under Section 24661 (without regard to this section).

(e) Notwithstanding the provisions of this section, any taxpayer who has, for ~~income~~ *taxable* years prior to the first ~~income~~ *taxable* year to which this section applies, reported his income under an established and consistent method or practice of accounting for prepaid subscription income (to which this section would apply if an election were made) may continue to report his income for ~~income~~ *taxable* years to which this part applies in accordance with such method or practice.

SEC. 187. Section 24676.5 of the Revenue and Taxation Code is amended to read:

24676.5. (a) A taxpayer who is on an accrual method of accounting may elect not to include in the gross income for the ~~income~~ *taxable* year the income attributable to the qualified sale of any magazine, paperback, or record which is returned to the taxpayer before the close of the merchandise return period.

(b) For purposes of this section—

(1) The term ‘‘magazine’’ includes any other periodical.

(2) The term ‘‘paperback’’ means any book which has a flexible outer cover and the pages of which are affixed directly to such outer cover. Such term does not include a magazine.

(3) The term ‘‘record’’ means a disc, tape, or similar object on which musical, spoken, or other sounds are recorded.

(4) If a taxpayer makes qualified sales of more than one category of merchandise in connection with the same trade or business, this section shall be applied as if the qualified sales of each such category were made in connection with a separate trade or business. For purposes of the preceding sentence, magazines, paperbacks, and records shall each be treated as a separate category of merchandise.

(5) A sale of a magazine, paperback, or record is a qualified sale if—

(A) At the time of sale, the taxpayer has a legal obligation to adjust the sales price of such magazine, paperback, or record if it is not resold, and

(B) The sales price of such magazine, paperback, or record is adjusted by the taxpayer because of a failure to resell it.

(6) The amount excluded under this section with respect to any qualified sale shall be the lesser of—

(A) The amount covered by the legal obligation described in paragraph (5)(A), or

(B) The amount of the adjustment agreed to by the taxpayer before the close of the merchandise return period.

(7) (A) Except as provided in subparagraph (B), the term ''merchandise return period'' means, with respect to any ~~income~~ *taxable* year—

(i) In the case of magazines, the period of 2 months and 15 days first occurring after the close of the ~~income~~ *taxable* year, or

(ii) In the case of paperbacks and records, the period of 4 months and 15 days first occurring after the close of the ~~income~~ *taxable* year.

(B) The taxpayer may select a shorter period than the applicable period set forth in subparagraph (A).

(C) Any change in the merchandise return period shall be treated as a change in the method of accounting.

(8) As prescribed by the Franchise Tax Board, the taxpayer may substitute, for the physical return of magazines, paperbacks, or records required by subdivision (a), certification or other evidence that the

magazine, paperback, or record has not been resold and will not be resold if such evidence—

(A) Is in the possession of the taxpayer at the close of the merchandise return period, and

(B) Is satisfactory to the Franchise Tax Board.

(9) A repurchase by the taxpayer shall be treated as an adjustment of the sales price rather than as a resale.

(c) (1) This section shall apply to qualified sales of magazines, paperbacks, or records, as the case may be, if and only if the taxpayer makes an election under this section with respect to the trade or business in connection with which such sales are made. An election under this section may be made without the consent of the Franchise Tax Board. The election shall be made in such manner as the Franchise Tax Board may prescribe and shall be made for any ~~income~~ *taxable* year not later than the time prescribed by law for filing the return for such ~~income~~ *taxable* year (including extensions thereof).

(2) An election made under this section shall apply to all qualified sales of magazines, paperbacks, or records, as the case may be, made in connection with the trade or business with respect to which the taxpayer has made the election.

(3) An election under this section shall be effective for the ~~income~~ *taxable* year for which it is made and for all subsequent ~~income~~ *taxable* years, unless the taxpayer secures the consent of the Franchise Tax Board to the revocation of such election.

(4) Except to the extent inconsistent with the provisions of this section, for purposes of this subtitle, the computation of taxable income under an election made under this section shall be treated as a method of accounting.

(d) In applying Section 24723 with respect to any election under this section which applies to magazines, the period of taking into account any decrease in taxable income resulting from the application of subdivision (b) of Section 24721 shall be the ~~income~~ *taxable* year for which the election is made and the four succeeding ~~income~~ *taxable* years.

(e) (1) In the case of any election under this section which applies to paperbacks or records, in lieu of applying Sections 24721 through 24725, the taxpayer shall establish a suspense account for the trade or business for the ~~income~~ *taxable* year for which the election is made.

(2) The opening balance of the account described in paragraph (1) for the first ~~income~~ *taxable* year to which the election applies shall be the largest dollar amount of returned merchandise which would have been taken into account under this section for any of the three immediately preceding ~~income~~ *taxable* years if this section had applied to such preceding three ~~income~~ *taxable* years. This paragraph and paragraph (3) shall be applied by taking into account only amounts attributable to the trade or business for which such account is established.

(3) At the close of each ~~income~~ *taxable* year the suspense account shall be—

(A) Reduced by the excess (if any) of—

(i) The opening balance of the suspense account for the ~~income~~ *taxable* year, over

(ii) The amount excluded from gross income for the ~~income~~ *taxable* year under subdivision (a), or

(B) Increased (but not in excess of the initial opening balance) by the excess (if any) of—

(i) The amount excluded from gross income for the ~~income~~ *taxable* year under subdivision (a), over

(ii) The opening balance of the account for the ~~income~~ *taxable* year.

(4) (A) In the case of any reduction under paragraph (3)(A) in the account for the ~~income~~ *taxable* year, an amount equal to such reduction shall be excluded from gross income for such ~~income~~ *taxable* year.

(B) In the case of any increase under paragraph (3)(B) in the account for the ~~income~~ *taxable* year, an amount equal to such increase shall be included in gross income for such ~~income~~ *taxable* year.

If the initial opening balance exceeds the dollar amount of returned merchandise which would have been taken into account under subdivision (a) for the ~~income~~ *taxable*

year preceding the first ~~income~~ *taxable* year for which the election is effective if this section had applied to such preceding ~~income~~ *taxable* year, then an amount equal to the amount of such excess shall be included in gross income for such first ~~income~~ *taxable* year.

(5) The application of this subdivision with respect to a taxpayer which is a party to any transaction with respect to which there is nonrecognition of gain or loss to any party to the transaction by reason of Chapter 8 shall be determined as prescribed by the Franchise Tax Board.

(6) The amendments to this section made by the 1979–80 Regular Session of the Legislature shall apply to ~~income~~ *taxable* years beginning on or after October 1, 1979.

SEC. 188. Section 24677 of the Revenue and Taxation Code is amended to read:

24677. (a) If an amount representing damages is received or accrued by a corporation during ~~an income~~ *a taxable* year as a result of an award in a civil action for breach of contract or breach of a fiduciary duty or relationship, then the tax attributable to the inclusion in gross income for the ~~income~~ *taxable* year of that part of the amount that would have been received or accrued by the corporation in a prior ~~income~~ *taxable* year or years but for the breach of contract, or breach of a fiduciary duty or relationship, shall not be greater than the aggregate of the increases in taxes that would have resulted had that part been included in gross income for that prior ~~income~~ *taxable* year or years.

(b) A corporation in computing the tax shall be entitled to deduct all credits and deductions for depletion, depreciation, and other items to which it would have been entitled, had the income been received or accrued by the corporation in the year during which it would have received or accrued it, except for the breach of contract or for the breach of fiduciary duty or relationship. The credits, deductions, or other items referred to in the prior sentence, attributable to property, shall be allowed only with respect to that part of the

award which represents the corporation's share of income from the actual operation of the property.

(c) Subdivision (a) shall not apply unless the amount representing damage is three thousand dollars ($3,000) or more.

SEC. 189. Section 24678 of the Revenue and Taxation Code is amended to read:

24678. (a) If an amount representing damages is received or accrued during ~~an income~~ *a taxable* year as a result of an award in, or settlement of, a civil action brought under Section 4 of the act entitled ''An act to supplement existing laws against unlawful restraints and monopolies, and for other purposes,'' approved October 15, 1914 (commonly known as the Clayton Act), for injuries sustained by a corporation in its business or property by reason of anything forbidden in the antitrust laws, then the tax attributable to the inclusion of that amount in gross income for the ~~income~~ *taxable* year shall not be greater than the aggregate of the increases in taxes which would have resulted if that amount had been included in gross income in equal installments for each month during the period in which the injuries were sustained by the corporation.

(b) This section shall apply to ~~income~~ *taxable* years ending after June 23, 1961, but only with respect to amounts received or accrued after that date as a result of awards or settlements made after that date.

SEC. 190. Section 24685 of the Revenue and Taxation Code is amended to read:

24685. (a) In the case of any taxpayer who elected to have former Section 24685 apply for that taxpayer's last ~~income~~ *taxable* year beginning prior to January 1, 1990, and who is required to change its method of accounting by reason of the amendments made by the act adding this section, each of the following shall apply:

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

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

(3) The net amount of adjustments required by Chapter 13 (commencing with Section 24631) to be taken into account by the taxpayer:

(A) Shall be reduced by the balance in the suspense account, under former Section 24685 as of the close of the last ~~income~~ *taxable* year beginning before January 1, 1990, and

(B) Shall be taken into account over the two ~~income~~ *taxable* year period beginning with the ~~income~~ *taxable* year following that last ~~income~~ *taxable* year, as follows:

In the case of the:	The percentage to be taken into account is:
1st Year	50
2nd Year	50

(b) Notwithstanding subparagraph (B) of paragraph (3) of subdivision (a), if the period during which the adjustments are required to be taken into account under Chapter 13 (commencing with Section 24631) is less than two years, those adjustments shall be taken into account ratably over the shorter period.

SEC. 191. Section 24690 of the Revenue and Taxation Code is amended to read:

24690. (a) The provisions of Section 468A of the Internal Revenue Code, relating to special rules for nuclear decommissioning costs, shall be applicable, except as otherwise provided.

(b) The deduction allowed for the 1987 ~~income~~ *taxable* year may include contributions to a fund that are required to bring the balance in that fund up to the balance it would have contained if allowable contributions had been made for the 1985 and 1986 ~~income~~ *taxable* years.

(c) The provisions of Section 468A(e)(2) of the Internal Revenue Code, which impose a tax upon the gross income of the Nuclear Decommissioning Reserve Fund, shall be modified for purposes of this part to provide that a tax shall be imposed upon the gross income of that fund for any taxable year at a rate equal to the rate

in effect for that taxable year under Section 23501. The income tax imposed upon the gross income of the fund by this section is in lieu of any other tax imposed by this part or Part 10 (commencing with Section 17001) upon or measured by that income.

SEC. 192. Section 24692 of the Revenue and Taxation Code is amended to read:

24692. (a) Section 469 of the Internal Revenue Code, relating to passive activity losses and credits limited, shall apply, except as otherwise provided.

(b) Section 469(c)(7) of the Internal Revenue Code, relating to special rules for taxpayers in real property business, shall not apply.

(c) Section 469(d)(2) of the Internal Revenue Code, relating to passive activity credits, is modified to refer to the following credits:

(1) The credit for research expenses allowed by Section 23609.

(2) The credit for clinical testing expenses allowed by Section 23609.5.

(3) The credit for low-income housing allowed by Section 23610.5.

(4) The credit for certain wages paid (targeted jobs) allowed by Section 23621.

(d) Section 469(g)(1)(A) of the Internal Revenue Code is modified to provide that if all gain or loss realized on the disposition of the taxpayer's entire interest in any passive activity (or former passive activity) is recognized, the excess of—

(1) The sum of—

(A) Any loss from that activity for that ~~income~~ *taxable* year (determined after application of Section 469(b) of the Internal Revenue Code), plus

(B) Any loss realized on that disposition, over

(2) Net income or gain for the ~~income~~ *taxable* year from all passive activities (determined without regard to losses described in paragraph (1)), shall be treated as a loss which is not from a passive activity.

(e) For purposes of applying Section 469(i) of the Internal Revenue Code, relating to the twenty-five

thousand dollars ($25,000) offset for rental real estate activities, the dollar limitation for the credit allowed under Section 23610.5 (relating to low-income housing) shall be equal to seventy-five thousand dollars ($75,000) in lieu of the amount specified in Section 469(i)(2) of the Internal Revenue Code.

(f) Section 502 of the Tax Reform Act of 1986 (Public Law 99-514) shall apply.

(g) For each ~~income~~ *taxable* year beginning on or after January 1, 1987, Section 10212 of Public Law 100-203, relating to treatment of publicly traded partnerships under Section 469 of the Internal Revenue Code, shall apply, except as otherwise provided.

(h) The amendments to Section 469(k) of the Internal Revenue Code made by Section 2004 of Public Law 100-647, relating to separate application of section in case of publicly traded partnerships, shall apply to each ~~income~~ *taxable* year beginning on or after January 1, 1990, except as otherwise provided.

SEC. 193. Section 24710 of the Revenue and Taxation Code is amended to read:

24710. (a) For each ~~income~~ *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-income-year~~ *five-taxable-year* period beginning with the first ~~income~~ *taxable* year beginning on or after January 1, 1997.

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

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

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

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

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

purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 23051.5.

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

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

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

SEC. 194. Section 24871 of the Revenue and Taxation Code is amended to read:

24871. (a) (1) Section 852(b)(1) of the Internal Revenue Code, relating to imposition of tax on regulated investment companies, shall not apply.

(2) Every regulated investment company shall be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except that its ‘‘net income’’ shall be equal to its ‘‘investment company income,’’ as defined in subdivision (b).

(b) ‘‘Investment company income’’ means investment company taxable income, as defined in Section 852(b)(2) of the Internal Revenue Code, modified as follows:

(1) Section 852(b)(2)(A) of the Internal Revenue Code, relating to an exclusion for net capital gain, shall not apply.

(2) Section 852(b)(2)(B) of the Internal Revenue Code, relating to net operating losses, is modified to deny the deduction allowed under Sections 24416 and 24416.1, in lieu of denying the deduction allowed by Section 172 of the Internal Revenue Code.

(3) In lieu of the provision of Section 852(b)(2)(C) of the Internal Revenue Code, relating to special deductions for corporations, no deduction shall be allowed under Section 24402.

(4) The deduction for dividends paid, under Section 852(b)(2)(D) of the Internal Revenue Code, is modified to allow capital gain dividends and exempt interest dividends (to the extent that interest is included in gross income under this part) to be included in the computation of the deduction.

(c) Section 852(b)(3)(A) of the Internal Revenue Code, relating to capital gains, shall not apply.

(d) Section 852(b)(5)(B) of the Internal Revenue Code, relating to treatment of exempt interest dividends by shareholders, shall not apply.

(e) Section 854 of the Internal Revenue Code, relating to limitations applicable to dividends received from regulated investment companies, is modified to refer to Section 24402, in lieu of Section 243 of the Internal Revenue Code.

(f) The amendments made to this section by the act adding this subdivision shall be operative for ~~income~~ *taxable* years beginning on or after January 1, 1993.

SEC. 195. Section 24871.5 of the Revenue and Taxation Code 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~~ *taxable* years of that entity beginning after August 5, 1997.

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

SEC. 196. Section 24872.4 of the Revenue and Taxation Code 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~~ *taxable* 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~~ *taxable* years beginning after August 5, 1997.

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

SEC. 197. Section 24872.5 of the Revenue and Taxation Code 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~~ *taxable* years of that entity beginning after August 5, 1997.

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

SEC. 198. Section 24872.7 of the Revenue and Taxation Code 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~~ *taxable* 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~~ *taxable* 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~~ *taxable* years beginning after August 5, 1997.

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

SEC. 199. Section 24905.5 of the Revenue and Taxation Code is amended to read:

24905.5. For each ~~income~~ *taxable* year beginning on or after January 1, 1997, the amendments made to Section 988 of the Internal Revenue Code by Section 13223 of the Revenue Reconciliation Act of 1993 (P.L. 103-66), relating to mark to market accounting method for securities dealers, shall apply.

SEC. 200. Section 24916 of the Revenue and Taxation Code is amended to read:

24916. Proper adjustment with regard to the property shall in all cases be made as follows:

(a) For expenditures, receipts, losses, or other items properly chargeable to capital account. However, no adjustment shall be made for any of the following:

(1) Sales or use tax paid or incurred in connection with the acquisition of property for which a tax credit is claimed pursuant to Section 23612.2.

(2) Taxes or other carrying charges described in Section 24426, or for expenditures described in Sections 24364 and 24369 for which deductions have been taken in determining net income for the ~~income~~ *taxable* year or any prior ~~income~~ *taxable* year.

(b) For exhaustion, wear and tear, obsolescence, amortization, and depletion:

(1) In the case of corporations subject to the tax imposed by Chapter 2 (commencing with Section 23101), to the extent sustained prior to January 1, 1928, and to the

extent allowed (but not less than the amount allowable) under this part, except that no deduction shall be made for amounts in excess of the amount which would have been allowable had depreciation not been computed on the basis of January 1, 1928, value and amounts in excess of the adjustments required by Section 113(b)(1)(B) of the Federal Revenue Act of 1938 for depletion prior to January 1, 1932.

(2) In the case of a taxpayer subject to the tax imposed by Chapter 3 (commencing with Section 23501), to the extent sustained prior to January 1, 1937, and for periods thereafter to the extent allowed (but not less than the amount allowable) under the provisions of this part.

(3) If a taxpayer has not claimed an amortization deduction for an emergency facility, the adjustment under paragraph (1) shall be made only to the extent ordinarily provided under Sections 24349 and 24372.

(c) In the case of stock (to the extent not provided for in the foregoing subdivisions) for the amount of distributions previously made which, under the law applicable to the year in which the distribution was made, either were tax free or were applicable in reduction of basis (not including distributions made by a corporation, which was classified as a personal service corporation under the provisions of the Federal Revenue Act of 1918 or 1921, out of its earnings or profits which were taxable in accordance with the provisions of Section 218 of the Federal Revenue Act of 1918 or 1921).

(d) (1) In the case of corporations subject to the tax imposed by Chapter 2 (commencing with Section 23101), in the case of any bond, as defined in Section 24363, to the extent of the deductions allowable pursuant to Section 24360 with respect thereto.

(2) In the case of taxpayers subject to the tax imposed by Chapter 3 (commencing with Section 23501), in the case of any bond, as defined in Section 24363, the interest on which is wholly exempt from the tax imposed by this part, to the extent of the amortizable bond premium disallowable as a deduction pursuant to subdivision (b) of Section 24360, and in the case of any other bond, as

defined in Section 24363, to the extent of the deductions allowable pursuant to subdivision (a) of Section 24360 (or the amount applied to reduce interest payments under paragraph (2) of subdivision (a) of Section 24363.5) with respect thereto.

(3) In the case of property pledged to the Commodity Credit Corporation, to the extent of the amount received as a loan from the Commodity Credit Corporation and treated by the taxpayer as income for the year in which received pursuant to Section 24273, and to the extent of any deficiency on that loan with respect to which the taxpayer has been relieved from liability.

(e) For amounts allowed as deductions as deferred expenses under Section 616(b) of the Internal Revenue Code, relating to certain expenditures in the development of mines, and resulting in a reduction of the taxpayer's tax, but not less than the amounts allowable under that section for the ~~income~~ *taxable* year and prior years.

(f) For amounts allowable as deductions as deferred expenses under Section 617(a) of the Internal Revenue Code, relating to certain exploration expenditures, and resulting in a reduction of the taxpayer's tax, but not less than the amounts allowable under that section for the ~~income~~ *taxable* year and prior years.

(g) For amounts allowed as deductions as deferred expenses under subdivision (a) of Section 24366, relating to research and experimental expenditures, and resulting in a reduction of the corporation's taxes under this part, but not less than the amounts allowable under that section for the ~~income~~ *taxable* year and prior years.

(h) For amounts allowed as deductions under Sections 24356.2, 24356.3, and 24356.4.

(i) (1) To the extent provided in Section 179A(e)(6)(A) of the Internal Revenue Code, relating to basis reduction for clean-fuel vehicles and certain refueling property.

(2) This subdivision shall apply to property placed in service after June 30, 1993, without regard to ~~income~~ *taxable* year.

(j) In the case of property the acquisition of which resulted under Section 1044 of the Internal Revenue Code, relating to rollover of publicly traded securities gain into specialized small business investment companies, in the nonrecognition of any part of the gain realized on the sale of other property, to the extent provided in Section 1044(d) of the Internal Revenue Code, relating to basis adjustments.

SEC. 201. Section 24918 of the Revenue and Taxation Code is amended to read:

24918. (a) Section 1017 of the Internal Revenue Code, relating to discharge of indebtedness, shall apply, except as otherwise provided. References to affiliated groups which file a consolidated return under Section 1501 of the Internal Revenue Code shall be treated as meaning members of the same unitary group which file a combined report under Article 1 (commencing with Section 25101) of Chapter 17.

(b) The amendments to Section 1017 of the Internal Revenue Code made by Section 13150 of the Revenue and Reconciliation Act of 1993 (Public Law 103-66), relating to modifications of discharge of indebtedness provisions, shall apply to discharges occurring on or after January 1, 1996, in ~~income~~ *taxable* years beginning on or after January 1, 1996.

SEC. 202. Section 24943 of the Revenue and Taxation Code is amended to read:

24943. If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(a) Into property similar or related in service or use to the property so converted, no gain shall be recognized.

(b) Into money, and the disposition of the converted property occurred before January 1, 1953, no gain shall be recognized if such money is forthwith in good faith, under regulations prescribed by the Franchise Tax Board, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such

other property, or in the establishment of a replacement fund. If any part of the money is not so expended, the gain shall be recognized to the extent of the money which is not so expended (regardless of whether such money is received in one or more ~~income~~ *taxable* years and regardless of whether or not the money which is not so expended constitutes gain). For purposes of this subsection and Section 24944, the term ‘‘disposition of the converted property’’ means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

For purposes of this section and Section 24944, the term ‘‘control’’ means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

SEC. 203. Section 24944 of the Revenue and Taxation Code is amended to read:

24944. If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, and the disposition of the converted property (as defined in subdivision (b) of Section 24943) occurred after December 31, 1952, the gain (if any) shall be recognized except to the extent hereinafter provided in this section:

(a) If the taxpayer during the period specified in subdivision (b), for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more ~~income~~ *taxable* years) exceeds the cost of such other

property or such stock. Such election shall be made at such time and in such manner as the Franchise Tax Board may by regulations prescribe. For purposes of this subdivision—

(1) No property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(2) The taxpayer shall be considered to have purchased property or stock only if, but for the provisions of Section 24947, the unadjusted basis of such property or stock would be its cost within the meaning of Section 24912.

(b) The period referred to in subdivision (a) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(1) Two years after the close of the first ~~income~~ *taxable* year in which any part of the gain upon the conversion is realized; or

(2) Subject to such terms and conditions as may be specified by the Franchise Tax Board, at the close of such later date as the Franchise Tax Board may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Franchise Tax Board may by regulations prescribe.

(c) For purposes of this section and Section 24943, replacement property ‘‘similar or related in service or use’’ shall include, in the case of a nonprofit water utility corporation, personal property used for the transmission or storage of water.

SEC. 204. Section 24945 of the Revenue and Taxation Code is amended to read:

24945. If a taxpayer has made the election provided in Section 24944(a), then—

(a) The statutory period for the assessment of any deficiency, for any ~~income~~ *taxable* year in which any part

of the gain on such conversion is realized, attributable to such gain shall not expire prior to the expiration of four years from the date the Franchise Tax Board is notified by the taxpayer (in such manner as the Franchise Tax Board may by regulations prescribe) of the replacement of the converted property or of an intention not to replace; and

(b) Such deficiency may be assessed before the expiration of such four-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

SEC. 205. Section 24946 of the Revenue and Taxation Code is amended to read:

24946. If the election provided in Section 24944(a) is made by the taxpayer and such other property or such stock was purchased before the beginning of the last ~~income~~ *taxable* year in which any part of the gain upon such conversion is realized, any deficiency, to the extent resulting from such election, for any ~~income~~ *taxable* year ending before such last ~~income~~ *taxable* year may be assessed (notwithstanding the provisions of Section 19057 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last ~~income~~ *taxable* year may be assessed.

SEC. 206. Section 24949.1 of the Revenue and Taxation Code, as amended by Section 98 of Chapter 322 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~~ *taxable* years beginning on or after January 1, 1998.

SEC. 207. Section 24952 of the Revenue and Taxation Code is amended to read:

24952. (a) If—

(1) A sale of real property gives rise to indebtedness to the seller which is secured by the real property sold, and

(2) The seller of such property reacquires such property in partial or full satisfaction of such indebtedness,

then, except as provided in subdivisions (b) and (d), no gain or loss shall result to the seller from such reacquisition, and no debt shall become worthless or partially worthless as a result of such reacquisition.

(b) (1) In the case of a reacquisition of real property to which subdivision (a) applies, gain shall result from such reacquisition to the extent that—

(A) The amount of money and the fair market value of other property (other than obligations of the purchaser) received, prior to such reacquisition, with respect to the sale of such property, exceeds

(B) The amount of the gain on the sale of such property included in the measure of tax or returned as income for periods prior to such reacquisition.

(2) The amount of gain determined under paragraph (1) resulting from a reacquisition during any ~~income~~ *taxable* year beginning after December 31, 1964, shall not exceed the amount by which the price at which the real property was sold exceeded its adjusted basis, reduced by the sum of—

(A) The amount of the gain on the sale of such property included in the measure of tax or returned as income for periods prior to the reacquisition of such property, and

(B) The amount of money and the fair market value of other property (other than obligations of the purchaser received with respect to the sale of such property) paid or transferred by the seller in connection with the reacquisition of such property.

For purposes of this paragraph, the price at which real property is sold is the gross sales price reduced by the

selling commissions, legal fees, and other expenses incident to the sale of such property which are properly taken into account in determining gain or loss on such sale.

(3) Except as provided in this section, the gain determined under this subdivision resulting from a reacquisition to which subdivision (a) applies shall be recognized, notwithstanding any other provision of this part.

(c) If subdivision (a) applies to the reacquisition of any real property, the basis of such property upon such reacquisition shall be the adjusted basis of the indebtedness to the seller secured by such property (determined as of the date of reacquisition), increased by the sum of—

(1) The amount of the gain determined under subdivision (b) resulting from such reacquisition, and

(2) The amount described in subparagraph (B) of paragraph (2) of subdivision (b).

If any indebtedness to the seller secured by such property is not discharged upon the reacquisition of such property, the basis of such indebtedness shall be zero.

(d) If, prior to a reacquisition of real property to which subdivision (a) applies, the seller has treated indebtedness secured by such property as having become worthless or partially worthless—

(1) Such seller shall be considered as receiving, upon the reacquisition of such property, an amount equal to the amount of such indebtedness treated by him as having become worthless, and

(2) The adjusted basis of such indebtedness shall be increased (as of the date of reacquisition) by an amount equal to the amount so considered as received by such seller.

SEC. 208. Section 24954 of the Revenue and Taxation Code is amended to read:

24954. For ~~income~~ *taxable* 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. 209. Section 24955 of the Revenue and Taxation Code is amended to read:

24955. (a) No gain shall be recognized with respect to a sale of an assisted housing development to a tenant association, nonprofit organization, profit-motivated organization or individual, or public agency which obligates itself and any successors in interest to maintain the assisted housing development affordable to persons or families of lower income or very low income for either a period of 30 years from the date of sale or the remaining term of existing federal government assistance as listed in subdivision (a) of Section 65863.10 of the Government Code, whichever is greater, provided that all of the proceeds from the sale are reinvested in residential real property, other than a personal residence, in this state within two years after the sale. This obligation shall be recorded at the time of sale in the office of the county recorder of the county in which the development is located.

(b) No gain shall be recognized with respect to a sale of a majority or more of units in an assisted housing development converted to condominium interests, to a tenant association, nonprofit organization, profit-motivated organization or individual, or public agency which obligates itself and any successors in interest to maintain the condominiums affordable to persons or families of lower income or very low income for either a period of 30 years from the date of sale or the remaining term of existing federal government assistance as listed in subdivision (a) of Section 65863.10 of the Government Code, provided that all of the proceeds from the sale are reinvested in residential real property, other than a personal residence, in this state within two years after the sale. This obligation shall be recorded at the time of sale in the office of the county recorder of the county in which the development is located.

(c) No gain shall be recognized with respect to a sale of real property to a majority or more of existing lower

income and very low income residents of that property, provided that all of the proceeds from the sale are reinvested in residential real property, other than a personal residence, in this state within two years after the sale.

(d) No gain shall be recognized with respect to a sale of a majority or more of units converted to condominium interests to the existing lower income or very low income residents of that property, provided that all of the proceeds from the sale are reinvested in residential real property, other than a personal residence, in this state within two years after the sale.

(e) For purposes of this section:

(1) ‘‘Assisted housing development’’ means a multifamily rental housing development that receives federal government assistance, appearing of record and containing a legal description of the property, as defined in subdivision (a) of Section 65863.10 of the Government Code.

(2) ‘‘Tenant association’’ means a group of tenants who have formed a nonprofit corporation, cooperative corporation, or other entity or organization; or a local nonprofit, regional, or national organization whose purpose includes the acquisition of an assisted housing development, real property, or condominium and which represents the interests of at least a majority of the tenants in the assisted housing development, real property, or condominium.

(3) ‘‘Nonprofit organization’’ means a not-for-profit corporation organized pursuant to Division 2 (commencing with Section 5000) of Title 1 of the Corporations Code, which has as its principal purpose the ownership, development, or management of housing or community development projects for persons and families of lower income and very low income, and which has a broadly representative board, a majority of whose members are community-based and has a proven track record of community service.

(4) ‘‘Public agency’’ means a housing authority, redevelopment agency, or any other agency of a city,

county, or city and county, whether general law or chartered, which is authorized to own, develop, or manage housing or community development projects for persons and families of lower income and very low income.

(5) ‘‘Regional or national organization’’ means a not-for-profit, charitable corporation organized on a multicounty, state, or multistate basis which has as its principal purpose the ownership, development, or management of housing or community development projects for persons and families of lower income and very low income.

(6) ‘‘Regional or national agency’’ means a multicounty, state, or multistate agency which is authorized to own, develop, or manage housing or community development projects for persons and families of lower income and very low income.

(7) ‘‘Profit-motivated organization or individual’’ means an individual or two or more persons organized pursuant to Division 1 (commencing with Section 100) of Title 1 of, Division 3 (commencing with Section 1200) of Title 1 of, or Division 1 (commencing with Section 15001) of Title 2 of, the Corporations Code, which carries on as a business for profit.

(8) ‘‘Lower income’’ means those residents having an income as defined by Section 50079.5 of the Health and Safety Code.

(9) ‘‘Very low income’’ means those residents having an income as defined by Section 50105 of the Health and Safety Code.

(10) ‘‘Resident’’ means a tenant or other person who lawfully occupies a unit located in a qualified low-income housing project as defined under Section 23610.5, and whose income qualifies as lower income or very low income.

(11) ‘‘Condominium’’ means the interest in real property defined in Section 783 of the Civil Code.

(f) If the purchase of residential real property results in the nonrecognition of gain on the sale of an assisted housing development, real property, or condominium

under subdivision (a), (b), (c), or (d), in determining the adjusted basis of the purchased residential real property as of any time following the sale of the assisted housing development, real property, or condominium, the adjustments to the basis shall include a reduction by an amount equal to the amount of the gain not so recognized on the sale of the assisted housing development, real property, or condominium. If more than one parcel of residential real property has been purchased, the nonrecognized gain from the sale of the assisted housing development, real property, or condominium shall be attributed to the parcels of residential real property on a pro rata basis based upon the purchase prices of those parcels.

(g) In accordance with subdivision (a), (b), (c), or (d), if the sale of an assisted housing development, real property, or condominium results in a gain during the ~~income~~ *taxable* year, then all of the following shall apply:

(1) The statutory period for the assessment of any deficiency attributable to any part of the gain shall not expire before the expiration of four years from the date the Franchise Tax Board is notified (on the form as the Franchise Tax Board may provide) of one of the following:

(A) The cost of purchasing the residential real property which satisfies the requirement of subdivision (a), (b), (c), or (d), and results in the nonrecognition of gain.

(B) The intention not to reinvest all of the proceeds from the sale in residential real property within the period specified in subdivision (a), (b), (c), or (d).

(C) The failure to reinvest all of the proceeds from the sale in residential real property within the period specified in subdivision (a), (b), (c), or (d).

(2) The deficiency may be assessed before the expiration of the period specified in paragraph (1), notwithstanding the provisions of any other law or rule of law which would otherwise prevent the assessment.

(3) All information regarding the sale of an assisted housing development, real property, or condominium, at

a gain in accordance with subdivision (a), (b), (c), or (d), shall be disclosed in the return for the ~~income~~ *taxable* year in which the sale took place in order to determine if the sale qualifies and the amount of nonrecognition of gain qualifies under subdivision (a), (b), (c), or (d).

(h) The Department of Housing and Community Development shall do all of the following:

(1) Certify that the lower income or very low income resident meets the definitions provided in paragraphs (8) and (9) of subdivision (e).

(2) Provide an annual listing to the Franchise Tax Board, in a form and manner agreed upon by the Franchise Tax Board and the Department of Housing and Community Development, of the names and identification numbers of the persons who are members of the group of purchasers who are lower income or very low income residents that were issued a certification, and the names and identification numbers of the sellers of the property.

(3) Provide the group of purchasers who are lower income or very low income residents a copy of the certification.

(i) The group of purchasers who are lower income or very low income residents shall do all of the following:

(1) Provide the Department of Housing and Community Development with documents, as deemed necessary by the department, verifying the income of each member of the group.

(2) Provide a copy of the certification to the seller of the assisted housing development, real property, or condominium.

(3) Retain a copy of the certification.

(j) The seller of the assisted housing development, real property, or condominium shall do all of the following:

(1) Obtain a copy of the certification from the group of purchasers who are lower income or very low income residents of the assisted housing development, real property, or condominium.

(2) Retain a copy of the group's lower income or very low income certification for tax purposes.

SEC. 210. Section 24956 of the Revenue and Taxation Code is amended to read:

24956. (a) Section 1044 of the Internal Revenue Code, relating to rollover of publicly traded securities gain into specialized small business investment companies, shall apply, except as otherwise provided.

(b) The provisions of Section 1044 of the Internal Revenue Code, relating to rollover of publicly traded securities gain into specialized small business investment companies, shall not apply to any ~~income~~ *taxable* year (or portion thereof) that those provisions (or similar provisions) are not applicable for federal income tax purposes.

SEC. 211. Section 24990.4 of the Revenue and Taxation Code is amended to read:

24990.4. For ~~income~~ *taxable* years beginning on or after January 1, 1997:

(a) Section 1237(a) of the Internal Revenue Code, relating to real property subdivided for sale, is modified to provide that the term ‘‘other than a corporation’’ in the material preceding Section 1237(a)(1) of the Internal Revenue Code shall instead mean ‘‘other than a C corporation.’’

(b) Section 1237(a)(2)(A) of the Internal Revenue Code, relating to real property subdivided for sale, is modified to provide that an improvement shall be deemed to be made by the taxpayer if that improvement was made by an ‘‘S corporation’’ that included the taxpayer as a shareholder.

SEC. 212. Section 24990.7 of the Revenue and Taxation Code is amended to read:

24990.7. The provisions of Section 1248 of the Internal Revenue Code, relating to gain from certain sales or exchanges of stock in certain foreign corporations, shall not apply to transactions occurring after August 20, 1990, in ~~income~~ *taxable* years beginning on or after January 1, 1990.

SEC. 213. 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~~ *taxable* years beginning on or after January 1, 1987, and before the ~~income~~ *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 ~~income~~ *taxable* years beginning before January 1, 1987, shall be included in gross income in the ~~income~~ *taxable* 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~~ *taxable* 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~~ *taxable* 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~~ *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-income-year~~ *four-taxable-year* period beginning with the first ~~income~~ *taxable* year beginning on or after January 1, 1998.

SEC. 214. Section 25101.3 of the Revenue and Taxation Code is amended to read:

25101.3. The property factor as it relates to the aircraft of an air carrier or foreign air carrier, as defined in Section 1150, or the operator of an air taxi, as defined in Section 1154, shall be allocated on the basis of a formula consisting of time and arrivals and departures as follows:

(a) The time in state is the proportionate amount of time, both in the air and on the ground, that certificated aircraft have spent within the state during the ~~income~~ *taxable* year as compared to the total time everywhere during the ~~income~~ *taxable* year. This factor shall be multiplied by 75 percent.

(b) Arrivals and departures is the number of arrivals in and departures from airports within the state of certificated aircraft during the ~~income~~ *taxable* year as compared to the total number of arrivals in and departures from airports both within this state and elsewhere during the ~~income~~ *taxable* year. This factor shall be multiplied by 25 percent.

(c) The time in state factor shall be added to the arrivals and departures factor.

(d) The figure produced by application of subdivision (c) equals the allocation to be applied to the original cost of property owned or rented by the taxpayer determined under the provisions of Section 25130.

(e) If annual statistics for the taxpayer's ~~income~~ *taxable* year are not available, statistics for representative periods designated by the Franchise Tax Board shall be used provided that permission to do so has been granted to the taxpayer by the Franchise Tax Board.

SEC. 215. Section 25105 of the Revenue and Taxation Code is amended to read:

25105. (a) For purposes of this article, other than Section 25102, the income and apportionment factors of two or more corporations shall be included in a combined report only if the corporations, otherwise meeting the requirements of Section 25101 or 25101.15, are members of a commonly controlled group.

(b) A ‘‘commonly controlled group’’ means any of the following:

(1) A parent corporation and any one or more corporations or chains of corporations, connected through stock ownership (or constructive ownership) with the parent, but only if—

(A) The parent owns stock possessing more than 50 percent of the voting power of at least one corporation, and, if applicable,

(B) Stock cumulatively representing more than 50 percent of the voting power of each of the corporations, except the parent, is owned by the parent, one or more corporations described in subparagraph (A), or one or more other corporations that satisfy the conditions of this subparagraph.

(2) Any two or more corporations, if stock representing more than 50 percent of the voting power of the corporations is owned, or constructively owned, by the same person.

(3) Any two or more corporations that constitute stapled entities.

(A) For purposes of this paragraph, ‘‘stapled entities’’ means any group of two or more corporations if more than 50 percent of the ownership or beneficial ownership of the stock possessing voting power in each corporation consists of stapled interests.

(B) Two or more interests are stapled interests if, by reason of form of ownership restrictions on transfer, or other terms or conditions, in connection with the transfer of one of the interests the other interest or interests are also transferred or required to be transferred.

(4) Any two or more corporations, all of whose stock representing more than 50 percent of the voting power of the corporations is cumulatively owned (without regard to the constructive ownership rules of paragraph (1) of subdivision (e)) by, or for the benefit of, members of the same family. Members of the same family are limited to an individual, his or her spouse, parents, brothers or sisters, grandparents, children and grandchildren, and their respective spouses.

(c) (1) If, in the application of subdivision (b), a corporation is eligible to be treated as a member of more than one commonly controlled group of corporations, the corporation shall elect to be treated as a member of only one commonly controlled group. This election shall remain in effect unless revoked with the approval of the Franchise Tax Board.

(2) Membership in a commonly controlled group shall be treated as terminated in any year, or fraction thereof, in which the conditions of subdivision (b) are not met, except as follows:

(A) When stock of a corporation is sold, exchanged, or otherwise disposed of, the membership of a corporation in a commonly controlled group shall not be terminated, if the requirements of subdivision (b) are again met immediately after the sale, exchange, or disposition.

(B) The Franchise Tax Board may treat the commonly controlled group as remaining in place if the conditions of subdivision (b) are again met within a period not to exceed two years.

(d) A taxpayer may exclude some or all corporations included in a ‘‘commonly controlled group’’ by reason of paragraph (4) of subdivision (b) by showing that those members of the group are not controlled directly or indirectly by the same interests, within the meaning of the same phrase in Section 482 of the Internal Revenue Code. For purposes of this subdivision, the term ‘‘controlled’’ includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised.

(e) Except as otherwise provided, stock is ‘‘owned’’ when title to the stock is directly held or if the stock is constructively owned.

(1) An individual constructively owns stock that is owned by any of the following:

(A) His or her spouse.

(B) Children, including adopted children, of that individual or the individual’s spouse, who have not attained the age of 21 years.

(C) An estate or trust, of which the individual is an executor, trustee, or grantor, to the extent that the estate or trust is for the benefit of that individual's spouse or children.

(2) Stock owned by a corporation, or a member of a controlled group of which the corporation is the parent corporation, is constructively owned by any shareholder owning stock that represents more than 50 percent of the voting power of the corporation.

(3) Stock owned by a partnership is constructively owned by any partner, other than a limited partner, in proportion to the partner's capital interest in the partnership. For this purpose, a partnership is treated as owning proportionately the stock owned by any other partnership in which it has a tiered interest, other than as a limited partner.

(4) In any case where a member of a commonly controlled group, or shareholders, officers, directors, or employees of a member of a commonly controlled group, is a general partner in a limited partnership, stock held by the limited partnership is constructively owned by a limited partner to the extent of its capital interest in the limited partnership.

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

(1) ''Corporation'' means a subchapter S corporation, any other incorporated entity, or any entity defined or treated as a corporation pursuant to Section 23038 or 23038.5.

(2) ''Person'' means an individual, a trust, an estate, a qualified employee benefit plan, a limited partnership, or a corporation.

(3) ''Voting power'' means the power of all classes of stock entitled to vote that possess the power to elect the membership of the board of directors of the corporation.

(4) ''More than 50 percent of the voting power'' means voting power sufficient to elect a majority of the membership of the board of directors of the corporation.

(5) ‘‘Stock representing voting power’’ includes stock where ownership is retained but the actual voting power is transferred in either of the following manners:

(A) For one year or less.

(B) By proxy, voting trust, written shareholder agreement, or by similar device, where the transfer is revocable by the transferor.

(g) The Franchise Tax Board may prescribe any regulations as may be necessary or appropriate to carry out the purposes of this section, including, but not limited to, regulations that do the following:

(1) Prescribe terms and conditions relating to the election described by subdivision (c), and the revocation thereof.

(2) Disregard transfers of voting power not described by paragraph (5) of subdivision (f).

(3) Treat entities not described by paragraph (2) of subdivision (f) as a person.

(4) Treat warrants, obligations convertible into stock, options to acquire or sell stock, and similar instruments as stock.

(5) Treat holders of a beneficial interest in, or executor or trustee powers over, stock held by an estate or trust as constructively owned by the holder.

(6) Prescribe rules relating to the treatment of partnership agreements which authorize a particular partner or partners to exercise voting power of stock held by the partnership.

(h) This section shall apply to ~~income~~ *taxable* years beginning on or after January 1, 1995.

SEC. 216. Section 25108 of the Revenue and Taxation Code is amended to read:

25108. (a) For corporations whose income is subject to the provisions of Section 25101 or 25101.15, the net operating loss determined in accordance with Section 172 of the Internal Revenue Code for a particular ~~income~~ *taxable* year shall be the corporation’s ‘‘net loss for state purposes’’ as defined in subdivision (c).

(b) The net operating loss deduction allowed by Sections 24416, 24416.1, and 24416.2, for ~~an income~~ *a*

taxable year shall be deducted from ‘‘net income for state purposes’’ (as defined in subdivision (c)) for that ~~income~~ *taxable* year.

(c) ‘‘Net income (loss) for state purposes’’ means the sum of the net income or loss of that corporation apportionable to this state and the income or loss allocable to this state as nonbusiness income, as provided by Chapter 17 (commencing with Section 25101).

SEC. 217. Section 25110 of the Revenue and Taxation Code is amended to read:

25110. (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b), that is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water’s-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer that makes a water’s-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(2) Any corporation (other than a bank), regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(3) Corporations that are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their voting stock is owned or controlled directly or indirectly by the same interests.

(4) A corporation that is not described in paragraphs (1) to (3), inclusive, or paragraph (5), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with

paragraph (3) of subdivision (b). Income of that corporation derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the corporation with respect to its activities conducted within the United States.

(5) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(6) Any affiliated corporation which is a ''controlled foreign corporation,'' as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code (''Subpart F income''). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the ''Subpart F income'' of that corporation for that ~~income~~ *taxable* year and the denominator of which is the ''earnings and profits'' of that corporation for that ~~income~~ *taxable* year, as defined in Section 964 of the Internal Revenue Code.

(7) (A) The income and factors of the above-enumerated corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted.

(B) The income and factors of a corporation that is not described in paragraphs (1) to (3), inclusive, and paragraph (5) and that is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (4).

(b) For purposes of this article and Section 24411:

(1) An ''affiliated corporation'' means a corporation that is a member of a commonly controlled group as defined in Section 25105.

(2) A ''qualified taxpayer'' means a corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporate individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 19504 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends received by any corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by members of the unitary group and which is engaged in the same general line of business.

(ii) Any corporation that is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or that sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. ''Significant,'' as used in this subparagraph,

means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations that set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) ''The United States'' means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.

SEC. 218. Section 25111 of the Revenue and Taxation Code is amended to read:

25111. (a) The making of a water's-edge election as provided for in Section 25110 shall be made by contract with the Franchise Tax Board in the original return for a year and shall be effective only if every taxpayer that is a member of the water's-edge group and which is subject to tax under this part makes the election. A single taxpayer that is engaged in more than one business activity subject to allocation and apportionment as provided in Article 2 (commencing with Section 25120) of Chapter 17 may make a separate election for each

business. The form and manner of making the water's-edge election shall be prescribed by the Franchise Tax Board. Each contract making a water's-edge election shall be for an initial term of 84 months, except as provided in subdivision (b). Each contract shall provide that on the anniversary date of the contract or any other annual date specified by the contract a year shall be added automatically to the initial term unless notice of nonrenewal is given as provided in subdivision (d). An affiliated corporation that is a member of the water's-edge group and subsequently becomes subject to tax under this part or is a nonelecting taxpayer that is subsequently proved to be a member of the water's-edge group pursuant to a Franchise Tax Board audit determination, as evidenced by a notice of deficiency proposed to be assessed or a notice of tax change, shall be deemed to have elected.

No water's-edge election shall be made for ~~an income~~ *a taxable* year beginning prior to January 1, 1988.

(b) A water's-edge election may be terminated by a taxpayer prior to the end of the 84-month period if either of the following occurs:

(1) The taxpayer is acquired directly or indirectly by a nonelecting entity which alone or together with those affiliates included in its combined report is larger than the taxpayer as measured by equity capital.

(2) With the permission of the Franchise Tax Board.

(c) In granting a change of election, the Franchise Tax Board shall impose any conditions that are necessary to prevent the avoidance of tax or to clearly reflect income for the period the election was, or was purported to be, in effect. These conditions may include a requirement that income, including dividends paid from income earned while a water's-edge election was in effect, which would have been included in determining the income of the taxpayer from sources within and without this state pursuant to Section 25101 but for the water's-edge election shall be included in income in the year in which the election is changed.

(d) If the taxpayer desires in any year not to renew the election, the taxpayer shall serve written notice of nonrenewal upon the board at least 90 days in advance of the annual renewal date. Unless that written notice is provided to the board, the election shall be considered renewed as provided in subdivision (a).

(e) If the taxpayer serves notice of intent in any year not to renew the existing water's-edge election, that existing election shall remain in effect for the balance of the period remaining since the original election or the last renewal of the election, as the case may be.

SEC. 219. Section 25111.1 of the Revenue and Taxation Code is amended to read:

25111.1. (a) For any ~~income~~ *taxable* year beginning on or after January 1, 1994, consideration for water's-edge contracts in existence as of that date is no longer provided for by law. Contracts entered into for ~~income~~ *taxable* years beginning prior to January 1, 1994, are rescinded for any periods remaining on those contracts commencing on the first day of the taxpayer's first ~~income~~ *taxable* year that begins on or after January 1, 1994. Any fiscal year taxpayer whose contract is in effect as of December 31, 1993, shall continue to be bound by that contract until the close of its ~~income~~ *taxable* year after January 1, 1994, and before December 31, 1994.

(b) Notwithstanding subdivision (a), and except for the purposes of Section 25115, all taxpayers that are members of a water's-edge group consisting of taxpayers with different ~~income~~ *taxable* years shall continue to be bound by the contract in effect as of December 31, 1993, until the ~~income~~ *taxable* year beginning prior to January 1, 1994, and ending in 1994 for each of the taxpayer members of the water's-edge group has ended.

SEC. 220. Section 25112 of the Revenue and Taxation Code is amended to read:

25112. (a) If a taxpayer electing to file under Section 25110 fails to supply any information described in subdivision (b), the taxpayer shall pay a penalty of one thousand dollars ($1,000) for each ~~income~~ *taxable* year with respect to which the failure occurs.

(b) A taxpayer electing to file pursuant to Section 25110 shall do all of the following:

(1) Retain and make available to the Franchise Tax Board, upon request, the documents and information, including any questionnaires completed and submitted to the Internal Revenue Service or qualified states, that are necessary to audit issues involving attribution of income to the United States or foreign jurisdictions under Sections 482, 861, 863, 902, and 904, and Subpart F of Part III of Subchapter N, or similar sections of the Internal Revenue Code.

(2) Identify, upon request, principal officers or employees who have substantial knowledge of, and access to, documents and records that discuss pricing policies, profit centers, cost centers, and the methods of allocating income and expense among these centers. The information shall include the employees' titles and addresses.

(3) Retain and make available, upon request, all documents and correspondence ordinarily available to a corporation included in the water's-edge election that are submitted to, or obtained from, the Internal Revenue Service, foreign countries or their territories or possessions, and competent authority pertaining to ruling requests, rulings, settlement resolutions, and competing claims involving jurisdictional assignment and sourcing of income that affect the assignment of income to the United States. The documents shall include all ruling requests and rulings on reorganizations involving foreign incorporation of branches, all ruling requests and rulings on changing a corporation's jurisdictional incorporation, and all documents that are ordinarily available to a corporation included in the water's-edge election that pertain to the determination of foreign tax liability, including examination reports issued by foreign taxing administrations. If the documents have been translated, the translations shall be furnished.

(4) Retain and make available, upon request, information filed with the Internal Revenue Service to

comply with Sections 6038, 6038A, 6038B, 6038C, and 6041 of the Internal Revenue Code.

(5) Upon request, prepare and make available for each corporation organized or created under the laws of the United States or a political subdivision thereof, of which 50 percent or more of its voting stock is directly or indirectly owned or controlled, the information that would be included in the forms described in paragraph (4) if those forms were required for United States corporations.

(6) Retain and make available, upon request, all state tax returns filed by each corporation included under subdivision (a) in each state, including the District of Columbia.

(7) Comply with reasonable requests for information necessary to determine or verify its net income, apportionment factors, or the geographic source of that income pursuant to the Internal Revenue Code.

(8) For purposes of this subdivision, information for any year shall be retained for that period of time in which the taxpayer's income or franchise tax liability to this state may be subject to adjustment, including all periods in which additional income or franchise taxes may be assessed or during which an appeal is pending before the State Board of Equalization or a lawsuit is pending in the courts of this state or the United States with respect to California franchise or income tax.

(c) If the failure continues for more than 90 days after the date on which the Franchise Tax Board mails notice of that failure to the taxpayer, the taxpayer shall pay a penalty (in addition to the amount required under subdivision (a)) of one thousand dollars ($1,000) for each 30-day period (or fraction thereof) during which the failure continues after the expiration of the 90-day period. The increase in any penalty under this subdivision shall not exceed twenty-four thousand dollars ($24,000).

(d) If the taxpayer fails to comply substantially with any formal document request arising out of the examination of the tax treatment of any item (hereafter in this section referred to as the ''examined item'') before

the 90th day after the date of the mailing of the request, any court having jurisdiction of a civil proceeding in which the tax treatment of the examined item is an issue may, upon motion by the Franchise Tax Board, prohibit the introduction by the taxpayer of documentation covered by that request.

(e) For purposes of this section, the time in which information is to be furnished (and the beginning of the 90-day period after notice by the Franchise Tax Board) shall be treated as beginning not earlier than the last day on which reasonable cause existed for failure to furnish the information.

(f) This section shall not apply with respect to any requested documentation if the taxpayer establishes that the failure to provide the documentation, as requested by the Franchise Tax Board, is due to reasonable cause. For purposes of subdivision (d), the fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the requested documentation is not reasonable cause unless, after in-camera review of the documentation, the court finds otherwise.

(g) For purposes of this section, the term ‘‘formal document request’’ means any request (made after the normal request procedures have failed to produce the requested documentation) for the production of documentation that is mailed by registered or certified mail to the taxpayer at its last known address and that sets forth all of the following:

(1) The time and place for the production of the documentation.

(2) A statement of the reason the documentation previously produced (if any) is not sufficient.

(3) A description of the documentation being sought.

(4) The consequences to the taxpayer of the failure to produce the documentation described in this section.

(h) Notwithstanding any other law or rule of law, any taxpayer to whom a formal document request is mailed may begin a proceeding to quash that request not later than the 90th day after the date the request was mailed.

In that proceeding, the Franchise Tax Board may seek to compel compliance with the request.

(i) The 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 shall have jurisdiction to hear any proceeding brought under subdivision (h). An order denying the petition shall be deemed a final order that may be appealed.

The running of the 90-day period referred to in subdivision (c) shall be suspended during any period during which a proceeding brought under subdivision (h) is pending.

(j) For purposes of this section, ‘‘documentation’’ means any documentation which may be relevant or material to the tax treatment of the examined item.

(k) The Franchise Tax Board, and any court having jurisdiction over a proceeding under subdivision (g), may extend the 90-day period referred to in subdivision (b).

(*l*) If any corporation takes any action as provided in subdivision (h), the running of any period of limitations under Sections 19057 to 19067, inclusive (relating to the assessment and collection of tax), or under Section 19704 (relating to criminal prosecutions) with respect to that corporation shall be suspended for the period during which the proceedings under subdivision (h) and appeals thereto are pending.

SEC. 221. Section 25124 of the Revenue and Taxation Code is amended to read:

25124. (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rent and royalties from tangible personal property are allocable to this state:

(1) If and to the extent that the property is utilized in this state, or

(2) In their entirety if the taxpayer’s commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents

and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the ~~income~~ *taxable* year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the ~~income~~ *taxable* year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

SEC. 222. Section 25129 of the Revenue and Taxation Code is amended to read:

25129. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the ~~income~~ *taxable* year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the ~~income~~ *taxable* year.

SEC. 223. Section 25131 of the Revenue and Taxation Code is amended to read:

25131. The average value of property shall be determined by averaging the values at the beginning and ending of the ~~income~~ *taxable* year but the Franchise Tax Board may require the averaging of monthly values during the ~~income~~ *taxable* year if reasonably required to reflect properly the average value of the taxpayer's property.

SEC. 224. Section 25132 of the Revenue and Taxation Code is amended to read:

25132. The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the ~~income~~ *taxable* year by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the ~~income~~ *taxable* year.

SEC. 225. Section 25134 of the Revenue and Taxation Code is amended to read:

25134. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during

the ~~income~~ *taxable* year, and the denominator of which is the total sales of the taxpayer everywhere during the ~~income~~ *taxable* year.

SEC. 226. Section 25141 of the Revenue and Taxation Code is amended to read:

25141. (a) For purposes of this section, the following definitions shall apply:

(1) ''Entity'' means an individual, corporation, association, partnership, limited liability company, estate, trust, or any combination thereof.

(2) ''Person'' means an individual or corporation.

(3) ''Professional athletic team'' means any entity which has all of the following characteristics:

(A) Employs concurrently during the ~~income~~ *taxable* year five or more persons, who are compensated for being participating members of an athletic team engaging in public contests.

(B) Is a member of a league composed of at least five entities which are engaged in the operation of an athletic team and which are located in this and other states or in other countries.

(C) Has total minimum paid attendance in the aggregate for all contests wherever played during the ~~income~~ *taxable* year of 40,000 persons.

(D) Has minimum gross income in the ~~income~~ *taxable* year of one hundred thousand dollars ($100,000).

(b) For purposes of this chapter, a team shall be considered to have its operations based in the state or country in which the team derives its territorial rights under the rules of the league of which it is a member.

(c) The business income of a professional athletic team derived directly or indirectly from its operations as a professional athletic team shall be allocated to this state pursuant to the following three-factor formula:

(1) Computation of the property factor under Section 25129:

(A) For a team that has its operations based in this state, the average value of all real and tangible personal property, wherever located, and owned or rented and used during the ~~income~~ *taxable* year, shall be deemed to

have been owned or rented and used in this state during the ~~income~~ *taxable* year.

(B) For a team that has its operations based outside of this state, the average value of all real and tangible personal property, wherever located, and owned or rented and used during the ~~income~~ *taxable* year, shall be deemed to have been owned or rented and used outside this state during the ~~income~~ *taxable* year.

(2) Computation of the payroll factor under Section 25132:

(A) For a team that has its operations based in this state, the total compensation paid everywhere during the ~~income~~ *taxable* year shall be deemed to have been paid in this state during the ~~income~~ *taxable* year.

(B) For a team that has its operations based outside of this state, the total compensation paid everywhere during the ~~income~~ *taxable* year shall be deemed to have been paid outside this state during the ~~income~~ *taxable* year.

(3) Computation of the sales factor under Section 25134:

(A) For a team that has its operations based in this state, the total sales everywhere during the ~~income~~ *taxable* year shall be deemed to have been made in this state during the ~~income~~ *taxable* year.

(B) For a team that has its operations based outside of this state, the total sales everywhere during the ~~income~~ *taxable* year shall be deemed to have been made outside this state during the ~~income~~ *taxable* year.

(d) If any team that has its operations based in this state is required to allocate or apportion a part of its business income derived directly or indirectly from its operations as a professional athletic team to another state or country by the laws, regulations, or requirements of the other state or country and pays an income or franchise tax measured by income thereon as a result of the allocation or apportionment, then all of the following shall apply:

(1) The business income of the team otherwise subject to this section shall be reduced for purposes of this section

by the amount of the business income which is allocated or apportioned to and taxed by the other state or country.

(2) This section shall not apply to any team in the same league that has its operations based in the other state or country, and the business income of any such team derived directly or indirectly from its operations as a professional athletic team shall be allocated or apportioned to this state in a manner consistent with the method of allocation or apportionment imposed by the other state or country on the business income of the team that has its operations based in this state.

(e) For purposes of the minimum tax imposed under Sections 23151 and 23151.1, an entity which operates a professional athletic team shall be treated as a corporation. The liability under Sections 23151 and 23151.1 of any corporation owning any portion or share of an entity shall be satisfied by payment of the minimum tax by that entity, if the corporation is not otherwise doing business in this state.

SEC. 227. (a) In enacting the amendments made by this act, the Legislature declares that the sole purpose of these amendments is to simplify the Bank and Corporation Tax Law by changing its terminology so that ‘‘income year’’ and ‘‘taxable year’’ have the same meaning for calendar and fiscal years beginning on or after January 1, 2000.

(b) The Legislature acknowledges that, because of the change in terminology resulting from these amendments, for the first taxable year beginning on or after January 1, 2000, the term ‘‘taxable year’’ will have two meanings. First, it will refer to the year for which the tax measured by the income of the preceding income year beginning in 1999 is payable (returns for the income year 1999 that are due on or after March 15, 2000). Second, it also will refer to the next tax measurement period (returns for the first taxable year, as redefined, beginning on or after January 1, 2000, due on or after March 15, 2001). Further, the Legislature acknowledges that this change in terminology may give rise to the appearance that the amount of tax required to be paid for the first taxable year

beginning on or after January 1, 2000, has been increased or the time for making the payment of tax for that taxable year has been accelerated. However, the Legislature finds and declares that the amendments made by this act merely are a change in terminology and that the actual amount of tax required to be paid and the time for making the payment of tax will not change as a result of this act.

SEC. 228. (a) Except as provided in subdivision (b), any section of any act enacted by the Legislature during the 2000 calendar year that does both of the following shall prevail over this act, whether that act is enacted prior to, or subsequent to, the enactment of this act:

(1) Takes effect on or before January 1, 2001.

(2) Amends, amends and renumbers, adds, repeals and adds, or repeals a section that is amended, amended and renumbered, added, repealed and added, or repealed by this act.

(b) This section shall not apply to Sections 23042, 23151, 23515.1, 23153, 23181, 23183, 23183.1, 23281, 23282, and 24631 of the Revenue and Taxation Code, as amended by this act.

CORRECTIONS

Text — Pages 35, 46, 47, 123, 130, 136, 160, 216, 278, 281, 285, 354, 355,

358, 359, 361, 374, 388, and 407.

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