

**Significant 1998 California Tax Law Developments:
Another Year of Tax Relief and Changes**

by Chris Micheli, Esq.

CONTENTS

- I. Legislative Overview
- II. "Fast-Track" Tax Bill - SB 519
 - A. Corrective Provisions
 - B. Conformity Provisions
- III. Extra Year of R&D Credit
- IV. State Budget Tax Relief
 - A. Horseracing License Fees - SB 27
 - B. Individuals' Tax Relief - AB 2797
 - C. Targeted Tax Incentives - AB 2798
- V. Other Tax Bills of Interest
 - A. Assembly Bills
 - B. Senate Bills
 - C. Vetoed Bills
- VI. Conclusion

Chris Micheli is an attorney and registered lobbyist for the Sacramento governmental relations firm of Carpenter Snodgrass & Associates (916/447-2251).

I. LEGISLATIVE OVERVIEW

1998 represents another significant year of changes to California's tax laws. Acting on a multi-billion dollar revenue surplus, the Legislature and Governor provided major tax relief to individuals and businesses.

Earlier in the year, the Legislature and Governor Wilson approved SB 519 (Stats. 1998, Ch. 7), a measure that provided retroactive conformity to selected provisions of federal tax law, and made a number of technical corrections to 1997's billion-dollar tax cut "mega-deal."

As SB 519 was signed into law prior to March 15, 1998 (the due date of the first quarterly payments), California law retroactively conformed to selected provisions of the federal Taxpayer Relief Act of 1997 (P.L. 105-34) effective on January 1, 1997.

In August 1998, the last month of the Legislative Session, the Legislature and Governor enacted three major bills: SB 27 (Stats. 1998, Ch. 335), AB 2797 (Stats. 1998, Ch. 322), and AB 2798 (Stats. 1998, Ch. 323).

As part of the 1998-99 California State Budget, important tax relief for individuals and businesses was provided. While most of the tax relief is guaranteed, the targeted business tax incentives were made contingent upon the outcome of Prop. 7 on the November ballot.

The purpose of this article is to briefly review the substantive provisions of important legislation considered during the 1998 Legislative Session.

II. "FAST-TRACK" TAX BILL - SB 519

SB 519 was signed into law prior to March 15, the first due date for 1997 returns. As a result of this expeditious enactment of SB 519, many of its provisions were retroactive to January 1, 1997. In addition, it contained a number of technical correction amendments to the 1997 "mega-deal."

A. CORRECTIVE PROVISIONS

The following are the technical correction provisions of SB 519:

Reinstates the penalty for individual retirement account trustees who failed to file returns in 1997 (CRTC § 19184). This provision had been contained in SB 455 (Stats. 1997, Ch. 611), the omnibus federal conformity bill, but was inadvertently "chaptered out" by SB 1233 (Stats. 1997, Ch. 612). SB 519 reinstated this provision.

Reinstates the 1997 filing requirement for taxpayers whose only income is from the sale of a personal residence (CRTC § 18510). Individual taxpayers need to consider gain from the sale of a principal residence as gross income in determining whether they need to file a California return for 1997. This requirement had been in SB 5 (Stats. 1997, Ch. 610), but was "chaptered out" by SB 1233. SB 519 reinstated this provision.

Reinstates the "targeted tax area" provided for Tulare County, which was established by AB 1217 (Stats. 1997, Ch. 602) (CRTC §§ 17039, 17276.2, 23036, and 24416.2). Two of the tax incentives under AB 1217 were inadvertently "chaptered out" by SB 1234. SB 519 reinstated these provisions.

Clarifies the merchant marine capital construction fund alternative minimum tax adjustment (CRTC § 23456). The provision in California law excepting these funds from the AMT was inadvertently deleted. SB 519 clarified this provision.

Clarifies the estimated tax payment requirement for qualified Subchapter S subsidiaries' minimum franchise tax (CRTC §§ 17731.5, 19023, 19024, 19025, 19149, 19365, 23800.5, 23801, 23813). The \$800 MFT must be paid for each qualified Subchapter S subsidiary on the parent company's return. The new law provides that the subsidiary's tax is subject to the estimated tax rules and penalties and that the tax is due and payable when an S corporation's first estimated tax payment is due. The

Franchise Tax Board (FTB) requested this amendment because the staff believe that it is the most efficient way to administer this tax. SB 519 reinstated this provision.

Clarifies the 1998 operative date for amendments to CRTC § 24411 relating to foreign source income. AB 1040 (Stats. 1997, Ch. 605) commenced these two effective dates prior to 1998. SB 519 corrected the date.

Adjusts the individual alternative minimum tax exemption amounts to correctly reflect inflation since 1987 (CRTC § 17062). This provision of SB 519 corrected errors in SB 1233, which had increased the AMT exemption amounts to higher levels.

SB 519 also **waived estimated tax penalties** due to any tax underpayment or estimated tax due for any period before April 15, 1998, so long as the payment was created or increased by any SB 519 provision (CRTC § 19136.3). To request the waiver, a taxpayer must complete the appropriate FTB forms.

B. CONFORMITY PROVISIONS

The following are the federal conformity provisions of SB 519:

Rollover of gain on the sale of certain California small business stock (IRC § 1045) (CRTC §§ 17062 and 18038.5). A taxpayer may roll over (tax-free) gain on the sale of qualified small business stock held for more than six months if the gains are used to purchase other small business stock. This provision, which applies to sales after August 5, 1997, only affects personal income taxpayers. California law continues the requirement that the new stock purchase be of a small business located in California.

Exclusion of deferred income from installment sales for livestock sold due to bad weather (IRC § 451) (CRTC §§ 17559, 18037.3, 24661.5 and 24949.1). Under federal law, a taxpayer may defer the payment of taxes for one year on income derived from the emergency sale of livestock due to floods or weather-related federal disasters. California law now allows this special treatment for livestock sales beginning on January 1, 1997 due to floods and other weather-related conditions, in addition to droughts. This provision also requires the taxpayer to make the same election as they made under federal law.

Termination of suspense accounts for family farm corporations (IRC § 447(I)) (CRTC § 24652.5). A family farm corporation with income of more than \$25 million during any year may not defer tax on income resulting from required changes in accounting methods. California repealed the provision that allowed family farm corporations to defer tax.

Repeal of the “short-short” rule for RICs and REITs (IRC §§ 851, 856, 857) (CRTC §§ 17088.5, 17088.6, 24871.5, 24872.4, 24872.5, 24872.7). California repealed the

30% gross income test for tax years beginning after August 5, 1997. These provisions had prohibited mutual funds and REITs from receiving more than 30% of their income from investments held for less than a certain period of time. As the FTB noted, California retains its non-conformity to various alternative taxes imposed on certain REIT income and activities, although such amounts remain includible in California taxable income.

Election for trustee payment of taxes on funeral trust earnings (IRC § 685) (CRTC § 17760.5). The trustee of a preneed funeral trust can shift the responsibility for filing and paying tax on trust earnings to the trustee, rather than the owners of the trust. California law conforms to federal law on the treatment of these trusts for tax years ending after August 5, 1997. The amount of tax paid on the annual earnings of the trust is determined under the income tax rate schedule applicable to trusts.

Interest abatement for Presidentially-declared disaster areas (IRC §§ 45(k), 912, 915, 1033(e)) (CRTC §§ 17201.5, 17207.4, 19109, 24347.6, 24374.4). A taxpayer may use an appraisal for the purpose of obtaining federal funds to substantiate a disaster loss. Victims of a Presidentially-declared disaster area are granted a 90-day extension of time to file and pay their taxes. Interest and penalties are abated during this time period. California law conforms to all of these provisions.

Survivor benefit income exemption for public safety officers who are slain in the line of duty (IRC § 101) (CRTC § 17132.6). California law conforms to federal law providing that survivor benefits are excluded from gross income for amounts paid on deaths occurring on or after January 1, 1997.

III. EXTRA YEAR OF R&D CREDIT

Also of interest is that SB 519 did not address the issue of California's conformity to certain provisions of the federal research and development tax credit commencing on January 1, 1997, rather than the intended date of January 1, 1998. AB 1042 (Stats. 1997, Ch. 613) conformed to the federal three-tier alternative incremental credit and two other provisions extended until June 30, 1998 by Congress in P.L. 105-34.

Despite AB 1042's provisions setting forth a January 1, 1998 commencement date, the effective date provision was "chaptered out" by SB 455. As a result, the provision specifying that the conformity did not apply for the 1997 tax year was not in effect. Hence, California law fully conformed to the federal provisions for 1997. Then, on January 1, 1998, lower percentages for the 3-tier alternative incremental credit took effect.

By way of background, on September 13, 1997, the Legislature passed two measures with conflicting provisions: SB 455 and AB 1042. These bills had conflicting provisions related to California's R&D tax credit.

SB 455 made two changes to the California Revenue & Taxation Code applicable to the R&D credit:

(1) It changed the effective date of California conformity to the Internal Revenue Code that was in effect on January 1, 1997 (i.e., before the changes made to the IRC by the Taxpayer Relief Act of 1997); and

(2) It specified that the changes made to IRC § 41 shall not be applicable.

After enactment of SB 455, AB 1042 was enacted, which conformed California law to the changes made to IRC § 41 effective January 1, 1998. Those changes included the three-tier alternative incremental credit (but substituted lower percentage rates than those contained in the federal law), the 75% credit for research consortia payments, and the start-up definition.

In order to make sense of this matter, an official written opinion was issued by the California Legislative Counsel (in which the Franchise Tax Board concurs) at the request of legislators. According to the opinion, as a result of the chaptering of AB 1042 after SB 455, the provision preventing state conformity to IRC § 41 contained in SB 455 was “chaptered out.”

Hence, because the effective date of the California Revenue & Taxation Code reference to the IRC was January 1, 1997 under SB 455, California law conformed to the version of IRC § 41 that was in effect on January 1, 1997 (including the higher federal percentages in the 3-tier credit).

SB 455 retained the other limitations on California’s R&D tax credit. Then, on January 1, 1998, the contents of AB 1042 took effect. As a result, the lower percentages for the three-tier credit took effect at that time.

It should be noted that, according to the Legislative Counsel opinion, California did not conform to the federal percentage of 20% for the basic and university-based research credits. It conformed to the federal percentages for the 3-tier alternative incremental credit for the 1997 tax year only.

Practitioners should also be aware that SB 519 did not “fix” California’s inadvertent conformity for the 1997 tax year only for AMT exemption amounts and the 40% deduction for self-employed health insurance premiums.

IV. STATE BUDGET TAX RELIEF

The 1998 State Budget accord reached by the Governor and legislative leaders contained quite a number of important tax law changes affecting a diverse group of personal income and corporate taxpayers. The State Budget tax relief is set forth in the following chart and then described in detail below:

1998 TAX RELIEF ESTIMATED FISCAL IMPACT

<u>PROVISION</u>	<u>'98-99</u>	<u>'99-00</u>	<u>'00-01</u>	<u>'01-02</u>	<u>'02-03</u>
<i>Horseracing License Fees Reduced in SB 27</i>	\$20 M	\$40 M	\$40 M	\$40 M	\$40 M
<i>Vehicle License Fee Cut in AB 2797 (25% permanent reduction)</i>	\$533 M	\$1.032 B	\$1.075 B	\$1.15 B	\$1.2 B
<i>Additional VLF Cuts (if trigger amount of new revenues is reached)</i>	\$0	\$0	\$430 M	\$989 M	\$2.04 B
<i>Other Tax Cuts in AB 2797 (Cardoza)</i>	\$775 M	\$263 M	\$277 M	\$346 M	\$356 M
a. Renters' Tax Credit (non-refundable; income caps; \$60/\$120)	\$133 M	\$141 M	\$144 M	\$147 M	\$150 M
b. Indexing of Senior Citizen Homeowners' and Renters' Programs	\$0	\$71 M	\$73 M	\$76 M	\$79 M
c. Accelerated child and dependent credit	\$612 M	\$22 M	\$23 M	\$24 M	\$25 M
d. Omnibus federal tax law conformity	\$30 M	\$29 M	\$32 M	\$38 M	\$39 M
e. Joint Strike Fighter tax credits	\$0	\$0	\$5 M	\$61 M	\$64 M
f. 1995 ESOP conformity	\$4 M	\$0	\$0	\$0	\$0
<i>Targeted Tax Cuts in AB 2798 (Machado) (contingent on defeat of Prop. 7 in November)</i>	\$52 M	\$88 M	\$95 M	\$97 M	\$103 M

a. Increased 3-tier R&D credit percentages	\$15 M	\$18 M	\$20 M	\$17 M	\$18 M
b. Increased self-employ health insurance deduction	\$0	\$12 M	\$14 M	\$16 M	\$18 M
c. Modify enterprise zone	\$3 M	\$3 M	\$3 M	\$3 M	\$3 M
d. Lower MFT for start-up companies	\$4 M	\$11 M	\$11 M	\$11 M	\$11 M
e. Space launch exemption expansion and permanency	\$4 M	\$8 M	\$8 M	\$8 M	\$8 M
f. Employer child care credit extended for 5 years	\$10 M	\$11 M	\$13 M	\$15 M	\$17 M
g. Estate tax conformity	\$3 M	\$3 M	\$3 M	\$3 M	\$3 M
h. MIC extended to software makers	\$6 M	\$7 M	\$8 M	\$9 M	\$10 M
i. Post-production equipment exemption	\$4 M	\$7.5 M	\$7.5 M	\$7.5 M	\$7.5 M
j. Perennial plants tax exemption	\$3.5 M	\$7 M	\$7 M	\$7 M	\$7 M
TOTAL TAX RELIEF	\$1.384 B	\$1.352 B	\$1.844 B	\$2.546 B	\$3.661 B
* = if triggers are reached					

A. HORSERACING LICENSE FEES - SB 27

This measure contains \$40 million annually in license fee relief for California's horseracing industry, which has long been struggling to maintain its viability in this state. Among the beneficiaries of the cuts in license fees are:

- Owner purses (\$16.1 million)
- Track commissions (\$13.8 million)
- Simulcast locations (\$1.7 million)
- Breeders and owners awards (\$2.2 million)
- Simulcast commissions and expenses (\$5 million)
- Stabling and vanning funds (\$1 million)

- Local governments (\$300,000)

It should be noted that, in 1996, SB 2000 (Maddy) (Stats. 1996, Ch. 1121) was enacted that provided \$10 million annually in license fee relief. However, the consensus among the industry was that this figure was insufficient to have a stimulus effect after the relief had been calculated and apportioned among the different breeds.

B. INDIVIDUALS' TAX RELIEF - AB 2797

This measure contains the following provisions:

Reduces the Vehicle License Fee (Gov't § 13340; Vehicle §§ 9551.1, 9551.2; CRTC §§ 10754, 10902, 11000, 11000.1) by a permanent 25% effective January 1, 1999. There could be additional reductions in the current 2% VLF if certain General Fund revenues are reached that exceed the Department of Finance revenue estimates issued in May 1998 for two consecutive years. This provision amounts to an annual savings over just over \$1 billion to taxpayers. About one-third of the VLF savings benefits businesses in this state that own and operate vehicles.

Reinstates a modified Renters' Tax Credit (CRTC § 17053.5) by making it non-refundable and only available to persons who have a federal adjusted gross income of \$25,000 or less (single) or \$50,000 or less (joint). Effective January 1, 1998, the tax credit is \$60 (single filers) and \$120 (joint or head of household filers). In addition, the FTB must index the phase-out amounts annually for inflation beginning January 1, 1999. The amount of the credit will remain the same. The credit has not been available to renters since 1992.

Increases the Dependent Exemption Credit (CRTC § 17054) to \$253 for the 1998 tax year (rather than \$120 per dependent). For tax years beginning in 1999, the amount is set at \$227 for each dependent (instead of \$222). Thereafter, the \$227 amount will be indexed for inflation. The credit is not refundable and may only be used to reduce tax liability.

Indexes the Senior Homeowners' and Renters' Tax Assistance (CRTC §§ 20514, 20543, 20544) programs by increasing the eligibility income cap on senior and disabled homeowners from \$13,200 to \$33,132 (the maximum household income cap had not been adjusted since 1989). It also adjusts the renters program household income brackets for inflation. This program provides cash assistance to people who are over age 62 or who are blind or disabled to assist them in making property tax payments. A similar proposal had been contained in SB 1464 (Brulte).

Conforms to Selected Federal Tax Law provisions that were enacted by Congress in the Taxpayer Relief Act of 1997 (81 provisions), Balanced Budget Act of 1997 (two provisions), and Revenue Reconciliation Act of 1993 (one provision). California's specified date of federal tax conformity has now been changed to January

1, 1998 (CRTC §§ 17024.5 and 23051.5). These provisions had been contained in SB 1496 (Alpert). Among the significant changes in state law affected by this state conformity bill are:

- Allows deduction of interest paid on student loans
- Allows shorter recovery period for calculating AMT depreciation
- Changes “principal place of business” definition for home office deduction
- Permits business expense deduction for environmental remediation costs incurred at a contaminated site
- Allows consideration of the fair market value of property in partnership property distributions
- Eliminates ACE depreciation for AMT calculations
- Enhances deduction for charitable contributions by corporations of any computer technology or equipment

It should also be noted that this new law retroactively conforms state law to the federal provisions relating to employee stock ownership plans for 1995.

Enacts Joint Strike Fighter Tax Credits (CRTC §§ 17053.36, 17053.37, 23636, 23637) including wage and property credits for tax years 2001 to 2006 to contractors and subcontractors who successfully bid on the proposed military fighter plane. To qualify for the credits, the credits must be reflected in the contract or subcontract bid. The wage credit is limited to \$10,000 per year. While the credits are nonrefundable, they may be carried over for seven years. These provisions had been contained in AB 1779 (Runner).

Increases Self-Employed Health Insurance Deduction (CRTC § 17273.1) for the 1998 tax year only from 25% to 40%, which represents only partial conformity to the federal deduction. Taxpayers may not claim the deduction if they are covered under their spouse’s employer-subsidized health plan. Under federal law, the current deduction is 45% and will be phased-in to 100% by 2007. Similar proposals had been contained in AB 1991 (Davis) and AB 305 (Wayne).

C. TARGETED TAX INCENTIVES - AB 2798

This measure contains the following ten targeted tax incentives that will take effect only if Proposition 7 is defeated by voters at the November 3 statewide election:

Increases Research and Development Tax Credit Percentages (CRTC §§ 17052.12 and 23609) (IRC § 41) to conform to an equivalent of 80% of the federal 3-tier alternative incremental credit percentages, rather than the current 55% equivalent. As a result, for 1998 tax years, the state percentages will be 1.32%, 1.76% and 2.2%. For 1997 tax years only, the state percentages were the same as the federal percentages (1.65%, 2.2% and 2.75%). A similar proposal had been in AB 1356 (Figueroa/Cunneen).

Decreases Corporate Minimum Franchise Tax (CRTC §§ 23153 and 23221) for new, small (gross income of less than \$1 million) corporations during their first two years in business. It would decrease the current \$600 MFT to \$300 for the first year and to \$500 (instead of \$800) in the second year. It applies to corporations formed on or after January 1, 1999. This proposal had been contained in SB 1435 (Hayden), SB 510 (Montieth), and SB 890 (O'Connell).

Expands Commercial Space Launch Exemption (CRTC § 6380) from the current sales/use tax for purchases on or after January 1, 1994 of equipment (e.g., fuel, satellites) used in commercial space launches statewide (it is currently limited to launches originating from Vandenberg AFB) and eliminates the January 1, 2004 sunset date, thereby making the exemption permanent. These provisions had been contained in AB 1765 (Runner) and SB 2037 (O'Connell).

Expands Enterprise Zone Program (Gov't §§ 7073, 7074, 7076.1, 7076.2; CRTC §§ 17053.33, 17053.34, 17053.47, 17053.70, 17053.74, 17276.2, 23612.2, 23622.7, 23622.8, 23633, 23634, 24416.2) by allowing current enterprise zones to expand in geographic size by an additional 5% to twenty percent, and to extend their lives an additional five years to 20 years. Current law provides for thirty-nine enterprise zones statewide, all of which have been designated. It also changes the apportionment formula used to calculate the value of tax incentives provided by eliminating the sales factor from the formula in order to remove the bias against manufacturers located in zones. It would limit income used in the formula to include California, rather than worldwide income. Also, the definition of qualified property would include data processing, communications, and production equipment. It would require the FTB to compile data related to the effectiveness of the program and to enable the Trade & Commerce Agency to audit and de-designate an enterprise zone. All provisions are effective beginning on or after January 1, 1998. These provisions had been contained in SB 2079 (Costa).

Increases Self-Employed Health Insurance Deduction (CRTC § 17273) (IRC § 162) permanently from the current 25% to 40% for tax years beginning on or after January 1, 1999. The current state deduction is 40% for 1998 only (see discussion of AB 2797 above). Taxpayers may not claim the deduction if they are covered under their spouse's employer-subsidized health plan. Under federal law, the current deduction is 45% and will be phased-in to 100% by 2007. Similar proposals had been contained in AB 1991 (Davis) and AB 305 (Wayne).

Reinstates Child Care Tax Credits (CRTC §§ 17052.17, 17052.18, 23617, 23617.5) for an additional five years through December 31, 2002. The credits are for building owners relating to their costs of establishing a child care program or facility to be used by their tenants' employees' children (limited to \$50,000), as well as for employers contributing to a qualified child care plan made on behalf of any dependent under the age of 12 of the employee (limited to \$360 per dependent). These credits, which equal 30% of the costs incurred, had expired at the end of 1997. Because the definition of

“contribution” was not amended, only direct payments made to child care providers will qualify for the credit. These provisions had been contained in AB 484 (Havice) and AB 642 (Baldwin).

Conforms to Estate Tax Laws (CRTC §§ 13534, 13550) (IRC §§ 6166, 6601, 6621) relating to installment tax payments and interest rates on delinquent payments. Two provisions are from the federal Taxpayer Relief Act of 1997 and would be effective on or after January 1, 1999. California’s estate tax is equal to the taxpayer’s maximum allowable federal credit. The first provision would allow taxpayers to pay any California estate tax in installments for decedents; the second provision would provide a 9% interest rate on delinquent payments (the current penalty for late payment is 12% per year). These provisions had been contained in AB 2249 (Poochigian).

Extends Tax Credit to Software Companies (CRTC §§ 17053.49, 23649) under the existing 6% manufacturers’ tax credit (adding SIC Codes 7371 to 7373). Effective for purchases made on or after January 1, 1998, the MIC includes taxpayers engaged in computer programming services, prepackaged software, and computer-integrated systems design. The credit would be available only for purchases of computers and computer peripheral equipment or capitalized labor used to construct the computers and peripherals. To qualify for the credit, this property must be used primarily to develop or manufacture custom or prepackaged software to the special order of the purchaser. These provisions had been contained in AB 1063 (Lempert/Cunneen) and AB 2441 (Campbell).

Exempts Postproduction or Teleproduction Equipment (CRTC § 6378) from the State’s 5% share of the sales/use tax for equipment purchased on or after January 1, 1999 and used primarily (50% or more of the time) in postproduction or teleproduction activities (NAICS Code 512191). This property will not qualify for the research and development tax credit. These provisions had been contained in AB 2427 (Knox).

Exempts Perennial Plants (CRTC § 6358) from the sales/use tax beginning on or after January 1, 1999. The plants must be used to produce food for human consumption. Current law exempts only seeds and annual plants. This would apply the exemption to all plants so that fruits, citrus and nut trees would qualify, as well as perennial plants like asparagus and rhubarb. These provisions had been contained in SB 1974 (Montieth).

Unfortunately, this entire bill and its ten provisions will not go into effect unless Proposition 7 is defeated. The language of the bill states that, if Prop. 7 passes, then all of the bill will be rendered inoperative as of the bill’s effective date (August 20, 1998).

This initiative would require the California Air Resources Board (CARB) to grant tax credit certificates totaling a maximum of \$218 million annually from 1999 through 2010 to fund emission reduction efforts, including the purchase or retrofit of equipment

and vehicles. Credits would be awarded in certain amounts based upon specific categories.

V. OTHER TAX BILLS OF INTEREST

In addition to the significant tax relief laws provided as part of the 1998 California Legislative Session, a number of other important measures were enacted into law.

A. ASSEMBLY BILLS

The following significant Assembly measures were enacted this year:

AB 3 (Baca) (Stats. 1998, Ch. 1012) increases from five to eight the number of Local Area Military Base Recovery Act (LAMBRA) zones that can be designated in California. These zones provide several tax incentives to assist closed military bases attract commercial development.

AB 168 (Torlakson) (Stats. 1998, Ch. 9) increases the maximum aggregate housing credit amount from \$35 million to \$50 million for the 1998 and 1999 calendar years. This increase is annually allocated for low-income housing credits by the Tax Credit Allocation Committee.

AB 469 (Cardoza) (Stats. 1998, Ch. 504) permits architects to form limited liability partnerships beginning on or after January 1, 1999.

AB 510 (Ashburn) (Stats. 1998, Ch. 49) clarifies throughout the Revenue & Taxation Code that a partnership is included within the meaning of the term "taxpayer."

AB 821 (Takasugi) (Stats. 1998, Ch. 612) creates the Taxpayer Bill of Rights under the Sales and Use Tax Law.

AB 1614 (Lempert/Cunneen) (Stats. 1998, Ch.) creates the California Internet Tax Freedom Act similar to the federal law on the same subject.

AB 1694 (Ackerman) (Stats. 1998, Ch. 80) clarifies the due date for partnership and limited liability company returns as on or before the fifteenth day of the fourth month following the close of the partnership's or LLC's taxable year. The law also clarifies that the FTB may suspend the powers of certain LLCs that fail to pay taxes.

B. SENATE BILLS

The following significant Senate measures were enacted this year:

SB 1397 (Brulte) (Stats. 1998, Ch. 962) creates the Holocaust Reparations Act to exclude from income amounts received as reparations payments.

SB 1741 (Alpert) (Stats. 1998, Ch. 417) requires the FTB to notify limited partnerships, when they file a final tax return, that the minimum franchise tax is due annually until the limited partnership files necessary dissolution documents with the Secretary of State.

C. VETOED BILLS

Also of interest to readers is the fact that Governor Wilson vetoed **AB 1469 (Ortiz)** on September 30, 1998. That bill would have enacted the Taxpayer's Bill of Rights Act of 1998 by providing several new taxpayer-friendly procedures and conforming to four provisions of the IRS Restructuring and Reform Act of 1998.

AB 1469 would have conformed to the following provisions of the '98 federal act: (1) innocent spouse relief; (2) suspension of statute of limitations on certain refund claims; (3) changes for calculating the exclusion for gain on sales of principal residence; and, (4) Roth IRA rollovers changes.

Unfortunately, AB 1469 also included a provision that would have closed what FTB staff called a "loophole" in CRTS § 25110, a provision in the water's-edge law that would permit certain controlled foreign corporations (CFCs) with Subpart F income to exclude a portion of its Subpart F income from their water's-edge apportionable income base. Governor Wilson vetoed the bill because he believed that the water's-edge provision deserved greater scrutiny before enactment.

SB 2234 (Revenue & Taxation Committee) was another measure that Governor Wilson vetoed. Sponsored by the FTB, this bill would have made numerous technical corrections to the Revenue & Taxation Code. Unfortunately, this bill, if signed, would have eliminated California's conformity to the '93 federal act concerning the ACE adjustment for the AMT.

This conformity provision had been enacted in AB 2797 as part of the State Budget accord. Once implemented, it provides \$11 million annually in tax savings to businesses. Had SB 2234 been signed into law, this conformity provision would not have taken effect. As a result, Governor Wilson vetoed SB 2234 so that California conforms to the '93 federal act provision.

VI. CONCLUSION

As a result of the enactment of SB 519, certain affected California taxpayers had to amend their 1997 returns or calculate their liabilities differently. The FTB issued Publication 1003, which is entitled "1997 Tax Law Changes Enacted in 1998," to guide taxpayers in this area.

Interested persons can get this publication, as well as the FTB staff analyses of all tax measures, from the FTB's Internet site at <http://www.ftb.ca.gov>.

The 1998 State Budget agreement provides important tax relief to California individuals and businesses, particularly personal income taxpayers. This relief was provided because the State had realized a budget surplus of over \$4 billion. Legislators from both political parties agreed that some of the windfall should appropriately be returned to taxpayers.

Due to the fact that AB 1469 (Ortiz), which would have conformed to a number of taxpayer bill of rights provisions, and two other technical corrections measures were vetoed by Governor Wilson on September 30, it will be necessary for the California Legislature to consider urgency legislation in early 1999. That urgency legislation is likely to include several conformity provisions, as well as corrections items.

Moreover, with the enactment of the federal IRS Restructuring and Reform Act and the Tax & Trade Relief Extension Act of 1998, California will have to consider another omnibus tax conformity measure for adoption in 1999. It is unlikely that such a measure will be adopted as an urgency statute because of the necessary legislative discussions that occur about tax conformity.

Finally, as long as the state economy continues to provide sufficient revenues, there will be efforts to enact additional tax relief for individuals and businesses. As a result, 1999 should be another important year for tax law changes in California.