

California Tax Law After the '99 Federal "Extenders" Bill

by **Chris Micheli and Gina Rodriquez**

In mid-November 1999, Congress passed a modest measure that extends the sunset dates for certain tax credits, as well as enacts a number of other tax law changes. President Clinton signed the measure on November 29, 1999 (H.R. 1180, P.L. 106-). This article provides a brief summary of the federal bill's provisions and whether California conforms, as well as a comparison chart showing the federal act and corresponding California law.

California's specified date of federal tax conformity remains January 1, 1998 (CRTC §§ 17024.5 and 23105.5), due to the legislative failure of AB 1208 (Rev. & Tax Cmte.), which would change the date to January 1, 1999. AB 1208 will be reconsidered by the California Legislature when it reconvenes on January 3, 2000. AB 1208 may be amended to include some of the provisions of the '99 federal act.

Chris Micheli is an attorney and registered lobbyist for Carpenter Snodgrass & Associates in Sacramento (916/447-2251). **Gina Rodriquez** is an enrolled agent and the Sacramento Editor for Spidell Publishing, Inc. (530/676-0662).

Summary of Federal Legislation

Title V of H.R. 1180, which is officially titled the "Ticket to Work and Work Incentives Improvement Act of 1999," contains the "Tax Relief Extension Act of 1999." H.R. 1180 also amends the Social Security Act to expand the availability of health care coverage for working individuals with disabilities, as well as to establish a Ticket to Work and Self-Sufficiency Program in the Social Security Administration to provide individuals with meaningful opportunities to work.

The Tax Relief Extension Act of 1999 is divided into three parts: Extensions, Other Time-Sensitive Provisions, and Revenue Offsets. The provisions of the Tax Relief Extension Act are the following:

Extensions

1. The research and development tax credits are extended from June 30, 1999 to June 30, 2004. This five-year extension is the longest in the history of the R&D credits. The 3-tier alternative incremental credit is increased by 1%, so that the three tiers of credit are 2.65%, 3.2%, and 3.75% (rather than 1.65%, 2.2%, and 2.75%, respectively). A taxpayer can only claim its July 1, 1999 to September 30, 2000 credits after October 1, 2000.

In addition, the credits are extended to research conducted in Puerto Rico and U.S. possessions. California law generally conforms to the Internal Revenue Code as it read on January 1, 1998, but the state credit is equal to 12% (rather than 20%) and it is permanent (SB 671, Ch. 93-881). The state's 3-tier credit percentages are lower and the 3-tier credit is permanent (AB 1042, Ch. 97-613). [IRC § 41; CRTS §§ 17052.12 and 23609]

2. Existing law is extended to December 31, 2001 to allow non-refundable personal credits to offset a taxpayer's regular tax in full (as opposed to only the amount by which regular tax exceeds the tentative minimum tax). This provision had previously existed only for the 1998 tax year. For the 2000 and 2001 tax years, the non-refundable credits may offset both regular tax and tentative minimum tax. California law conforms in concept, but this provision is permanent (AB 1637, Ch. 99-930). [IRC §§ 24 and 26; CRTS § 17039]

3. The work opportunity tax credit is extended from June 30, 1999 to December 31, 2001. California law does not have a similar credit. [IRC § 51(c)]

4. The welfare-to-work tax credit is extended from June 30, 1999 to December 31, 2001. California law does not have a similar credit. [IRC § 51A]

5. The tax credit for holders of qualified zone academy bonds for public school construction and repairs is extended to December 31, 2001. California law does not have a similar credit. [IRC § 1397E]

6. The \$5,250 income exclusion for employer-provided undergraduate tuition assistance is extended for courses beginning before January 1, 2002 (instead of June 1, 2000). It does not include graduate-level tuition payments. California law conforms, but the state exclusion is permanent (SB 38, Ch. 96-954). [IRC § 127; CRTS § 17151]

7. The provision for expensing environmental ("brownfields") remediation costs is extended to December 31, 2001. California law conforms to federal law as it read on January 1, 1998 (AB 2797, Ch. 322). [IRC § 198(h); CRTS §§ 17279.4 and 24369.4]

8. The Subpart F exemption for certain active financing income for foreign corporations is extended to December 31, 2001. California law does not recognize this exemption. [IRC §§ 953 and 954; CRTS § 25110]

9. The \$5,000 tax credit for first-time homebuyers in Washington, D.C. is extended by one year to December 31, 2001. California law does not have a similar credit. [IRC § 1400C]

10. The tax credit for electricity production from certain renewable resources is extended to facilities placed in service by December 31, 2001. Qualified facilities include those using wind, closed-loop biomass, and poultry waste. The credit does not apply to electricity sold to utilities under certain contracts. California law does not have a similar credit. [IRC § 45(c)]

11. It extends from June 30, 1999 to September 30, 2001 the Trade Adjustment Assistance program (duty-free treatment under Generalized System of Preferences) that

provides aid to workers and companies injured by imports from developing countries. California law does not conform because this is a federal aid program. [§ 505 of the Trade Act of 1974]

12. It temporarily increases the amount of rum excise tax covered over to Puerto Rico and the U.S. Virgin Islands. California law does not impose such an excise tax. [IRC § 7652(f)]

13. It extends the suspension of the taxable income limit on percentage depletion for marginal production to December 31, 2001. California law conforms to federal law as it read on January 1, 1998 (AB 2797, Ch. 322). [IRC § 613A; CRTC §§ 17681 and 24381]

Other Time-Sensitive Provisions

14. Advance pricing agreements are treated as confidential taxpayer information and are excepted from public inspection. An annual report regarding advance pricing agreements must be prepared by the Treasury Secretary. California law does not conform because this is a new federal provision. [IRC §§ 6103(b) and 6110(b)]

15. Authority is granted to the Treasury Secretary to postpone up to 90 days certain tax-related deadlines by reason of Y2K failures. It also permits the abatement of interest and penalties. California law does not conform because this is a new federal provision. [Act § 522]

16. It includes certain vaccines against streptococcus pneumoniae in the list of taxable vaccines. California law does not conform because this is a new federal provision. [IRC §§ 4131 and 4132(a)(1)]

17. It delays the effective date of the requirement for approved diesel or kerosene terminals from July 1, 2000 to January 1, 2002. This requirement is contained in the Taxpayer Relief Act of 1997. California law does not have a comparable provision. [TRA of '97 § 1032(f)]

18. Farmers must disregard any option to accelerate the receipt of any payment under a production flexibility contract in determining the taxable year for which such payment is properly includible in gross income. California law does not conform because this is a new federal provision. [Act § 525]

Revenue Offsets

19. It modifies the individual estimated tax safe harbor rules by requiring high-income taxpayers to pay 108.6% (instead of 106%) of the preceding year's tax for the 2000 taxable year and 110% (instead of 106%) for the 2001 taxable year. The 112% requirement for the 2002 taxable year remains unchanged. California law partially conforms, but uses 105% of the prior year's tax effective January 1, 1997 (SB 455, Ch. 611). [IRC § 6654; CRTC §§ 19136 and 19136.2]

20. It clarifies the tax treatment of income and losses on derivatives by adding three new categories to the list of assets the gain or loss on which is treated as ordinary. California law does not conform because this is a new federal provision. [IRC § 1221]

21. It expands the reporting of cancellation of indebtedness income by any organization a significant trade or business of which is the lending of money (e.g., finance companies and credit card companies) for debts discharged on or after January 1, 2000. California law does not conform because this is a new federal provision. [IRC § 6050P]

22. It limits the amount of long-term capital gains that a taxpayer can recognize from certain derivative contracts (constructive ownership transactions) with respect to certain financial assets. This provision generally applies to transactions entered into on or after July 12, 1999. California law does not conform because this is a new federal provision. [IRC § 1260]

23. It extends to December 31, 2005 the present law permitting qualified transfers of excess defined benefit pension plan assets to provide retiree health benefits under a section 401(h) account. California law partially conforms effective January 1, 1997 (SB 455, Ch. 611). [IRC § 420; ERISA §§ 101, 403, and 408; CRTS § 17501]

24. For sales or other dispositions entered into on or after the enactment date of the new law, it modifies the installment method and prohibits the use of the installment method by accrual method taxpayers. It also modifies the pledge rule. California law does not conform because these are new federal provisions. [IRC §§ 453 and 453A]

25. It denies a charitable contribution deduction for transfers associated with split-dollar insurance arrangements. It also imposes an excise tax on IRC § 170(c) organizations and requires annual reporting. California law does not conform because this is a new federal provision. [IRC § 501(c)(28)]

26. This concerns distributions by a partnership to a corporate partner of stock in another corporation. It changes the amount of the basis reduction, and modifies partnership distributions resulting in control. California law partially conforms to federal law as it read on January 1, 1998 (AB 2797, Ch. 322). [IRC § 732; CRTS § 17851]

27. This modifies the treatment of income and services provided by taxable REIT subsidiaries. California law does not conform because these are new federal provisions. [IRC §§ 852, 856, and 857]

28. Certain exceptions for taxable REIT subsidiaries are provided. California law does not conform because this is a new federal provision. [IRC § 856(i)]

29. Earnings stripping for REITs is limited. California law does not conform because this is a new federal provision. [IRC § 163(j)]

30. A 100 percent tax on improperly allocated amounts is imposed. California law does not conform because this is a new federal provision. [IRC § 857]

31. It requires a study of taxable REIT subsidiaries. California law does not conform because the provision is not applicable. [Act § 547]

32. It permits a REIT to own and operate a health care facility for at least two years. California law does not conform because this is a new federal provision. [IRC § 856]

33. The REIT distribution requirements are modified to conform to regulated investment company rules. California law does not conform because this is a new federal provision. [IRC § 857]

34. It clarifies the exception for independent operators relating to REITs. California law does not conform because this is a new federal provision. [IRC § 856]

35. This modifies the earnings and profits rules for RICs and REITs to provide a more specific ordering rule, similar to the present-law REIT rule. California law does not conform because these are new federal provisions. [IRC § 852]

36. This modifies the estimated tax rules for closely-held real estate investment trusts. California law does not conform because these are new federal provisions. [IRC § 6655]

H.R. 1180 also allows the states to offer annual wage reporting for domestic (household) employees. This will allow some domestic employers to report and pay taxes on their household wages with their individual tax returns.

Comparison Chart

The following is a chart listing the '97 federal act provisions and the corresponding California provisions, if applicable:

TAX RELIEF EXTENSION ACT OF 1999 -- "EXTENDERS BILL" (P.L. 106-)

ACT §	FEDERAL LAW	IRC §	CALIFORNIA LAW	CRTC §
501	Allows all nonrefundable personal tax credits to offset regular tax liability below TMT until 12/31/01	24 and 26	Partially conforms (AB 1637); Eff. 1/1/99; CA law is permanent only for exemption credits	17039
502	Extended R&D tax credit to 6/30/04; extended credit to research in Puerto Rico and U.S. possessions; increased 3-tier credits by 1% each	41	Partially conforms (AB 1042) (AB 2798) (SB 705); Eff. 1/1/97; CA tax credit is permanent; different credit percentages	17052.12 and 23609
503	Extended Subpart F exemption for active financing income for foreign corporations to 12/31/01	953 and 954	Not applicable; CA does not have a comparable law	Not applicable
504	Suspension of taxable income limit on percentage depletion for marginal production was extended to 12/31/01	613A	Conforms (AB 2797); Eff. 1/1/98	17681 and 24381
505	Extended work opportunity tax credit to 12/31/01	51(c)	Does not conform	Not applicable
505	Extended welfare-to-work tax credit to 12/31/01	51A	Does not conform	Not applicable
506	Extended income exclusion for employer-paid tuition assistance to 12/31/01	127	Conforms (SB 38); Eff. 1/1/96; CA law is permanent	17151

507	Extended and modified tax credit for production of electricity from renewable resources to 12/31/01	45(c)	Does not conform	Not applicable
508	Extended trade adjustment assistance programs (duty-free treatment under GSP) to 9/30/01	Trade Act of '74 § 505	Not applicable	Not applicable
509	Extended credit for holders of qualified zone academy bonds to 12/31/01	1397E	Not applicable	Not applicable
510	Extended credit for first-time homebuyers in Wash., D.C. to 12/31/01	1400C	Not applicable	Not applicable
511	Extended expensing of environmental remediation costs to 12/31/01	198(h)	Conforms (AB 2797); Eff. 1/1/98	17279.4 and 24369.4
512	Increased temporarily the amount of rum excise tax covered over to Puerto Rico and Virgin Islands	7652(f)	Not applicable	Not applicable
521	Advance pricing agreements treated as confidential taxpayer information	6103(b) and 6110(b)	Does not conform	19543 - 19553
522	Authority to postpone certain tax-related deadlines by 90 days due to Y2K failures	Act § 522	Does not conform	Not applicable
523	Added vaccines against streptococcus pneumoniae to list of taxable vaccines	4132 (a)(1)	Does not conform	Not applicable
524	Delayed the effective date of requirement for approved diesel or kerosene terminals	TRA of '97 § 1032(f)	Does not conform	Not applicable
525	Disregards some production flexibility contract payments	Act § 525	Does not conform	Not applicable
531	Modified the individual estimated tax safe harbor rules for 2000 and 2001	6654	Partially conforms (SB 455) (AB 2797); Eff. 1/1/97; CA uses 105% prior year's tax	19136 and 19136.2
532	Clarified tax treatment of income and loss on derivatives	1221	Does not conform	Not applicable
533	Expanded reporting of cancellation of indebtedness income	6050P	Does not conform	18645
534	Limited conversions of character of income from constructive ownership transactions	1260	Does not conform	Not applicable
535	Treatment of excess pension assets used for retiree health benefits	420 and ERISA §§ 101, 403, 408	Partially conforms (SB 455); Eff. 1/1/97	17501
536	Modified installment method and repealed the method for accrual taxpayers	453 and 453A	Does not conform	Not applicable

537	Denial of a charitable contribution deduction for transfers associated with split-dollar insurance arrangements	5 0 1 (c)(28)	Does not conform	Not applicable
538	Distributions by partnerships to a corporate partner of stock in another corporation	732	Partially conforms (AB 2797); Eff. 1/1/98	17851
542	Treatment of income and services provided by taxable REIT subsidiaries	8 5 2 , 856, 857	Does not conform	24870, 24872, 24872.4
543	Exceptions for taxable REIT subsidiaries are provided	856(i)	Does not conform	24872.4
544	Limitation on earnings stripping for REITs	163(j)	Does not conform	Not applicable
545	100% tax on improperly allocated amounts	857	Does not conform	Not applicable
546	Effective date	A c t § 546	Not applicable	Not applicable
547	Study relating to taxable REIT subsidiaries	A c t § 547	Not applicable	Not applicable
551	Permits REITs to own health care facilities	856	Does not conform	Not applicable
556	Conformity with regulated investment company rules for REIT distributions	857	Does not conform	Not applicable
561	Clarified exception for REIT independent contractors	856	Does not conform	Not applicable
566	Modified earnings and profits rules for RICs/REITs	852	Does not conform	Not applicable
571	Modified estimated tax rules for closely-held REITs	6655	Does not conform	1 9 1 4 2 a n d 19144

SB 38 (Lockyer/Pringle, Stats. 1996, Ch 954)
 AB 1042 (Wayne, Stats. 1997, Ch. 613)
 SB 455 (Alpert, Stats. 1997, Ch. 611)
 AB 2797 (Cardoza, Stats. 1998, Ch. 322)
 AB 2798 (Machado, Stats. 1998, Ch. 323)
 AB 1637 (Rev. & Tax Cmte., Stats. 1999, Ch. 930)
 SB 705 (Sher, Stats. 1999, Ch. 77)